Managing resource wealth

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- Resource revenues can transform countries: + or -
- What does international experience tell us?
- What are the policy decisions?

Why are natural resources different?

- Natural resources can be a ***means*** to growth:
  provide capital/ foreign exchange/ public funds for broader development.
- BUT: The resource curse: technically and politically difficult to manage:
  - Owned by the state – not the property of any individual:
  - Yield pure economic rent
  - Volatile: commodity price variability
  - Scale: dominant activity in many countries
  - Long term sunk investments
  - Exhaustible:
    - Time profile of production and benefit

International Experiences: outcomes

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:
- Volatility has been particularly damaging

International Experiences: outcomes

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.

Key decision points:

Fundamental issue: Transform underground assets into surface assets (human and physical) that support jobs and generate income.

‘Weakest link’ problem – have to get all stages right.

1: Resource development and revenue capture

2: Saving and spending

3: The private sector: diversification & Dutch disease

I: Development and revenue capture

Trade-off:

- Need to attract investors and resource development:
- Need to capture the economic rent:
  - Fiscal regimes, royalties, corporate income tax, equity shares, prodn. sharing, signature bonuses

- Mistakes have been made in both directions:

Too generous: Zambia, 0.8% copper royalty

Land deals

***Too onerous*:** Threat of heavy tax/ expropriation ➔ Africa under-explored: mineral wealth per km^2 20% that in OECD

I: Development and revenue capture

Managing and improving the trade-off:

- Long term security of investment that is *credible*:
  - Generous regimes not sustainable?
  - Stabilisation clauses too rigid?
  - Fiscal systems that are responsive to changes;
  - Contract/ fiscal renegotiation will happen – but should be constrained by arbitration?
- Regulatory structure:
- Auction of rights:
  - Transparent
  - Gets maximum value
- Prior information to attract investors:
  - Public geological surveys:
- Transparency: Extractive Industries Transparency Initiative.

II: Saving and spending

Once revenue is flowing, what happens to the money?

Alternatives:

- Current ‘consumption’ – current benefit (but not the creation of lasting assets)
- Investment in the domestic economy
- Investment in overseas fund

‘domestic spending’

‘saving’

Different countries have made quite different choices

Three main lessons from experience

II: Saving and spending

1) Need for high saving rate:

Arguments for ‘consuming’

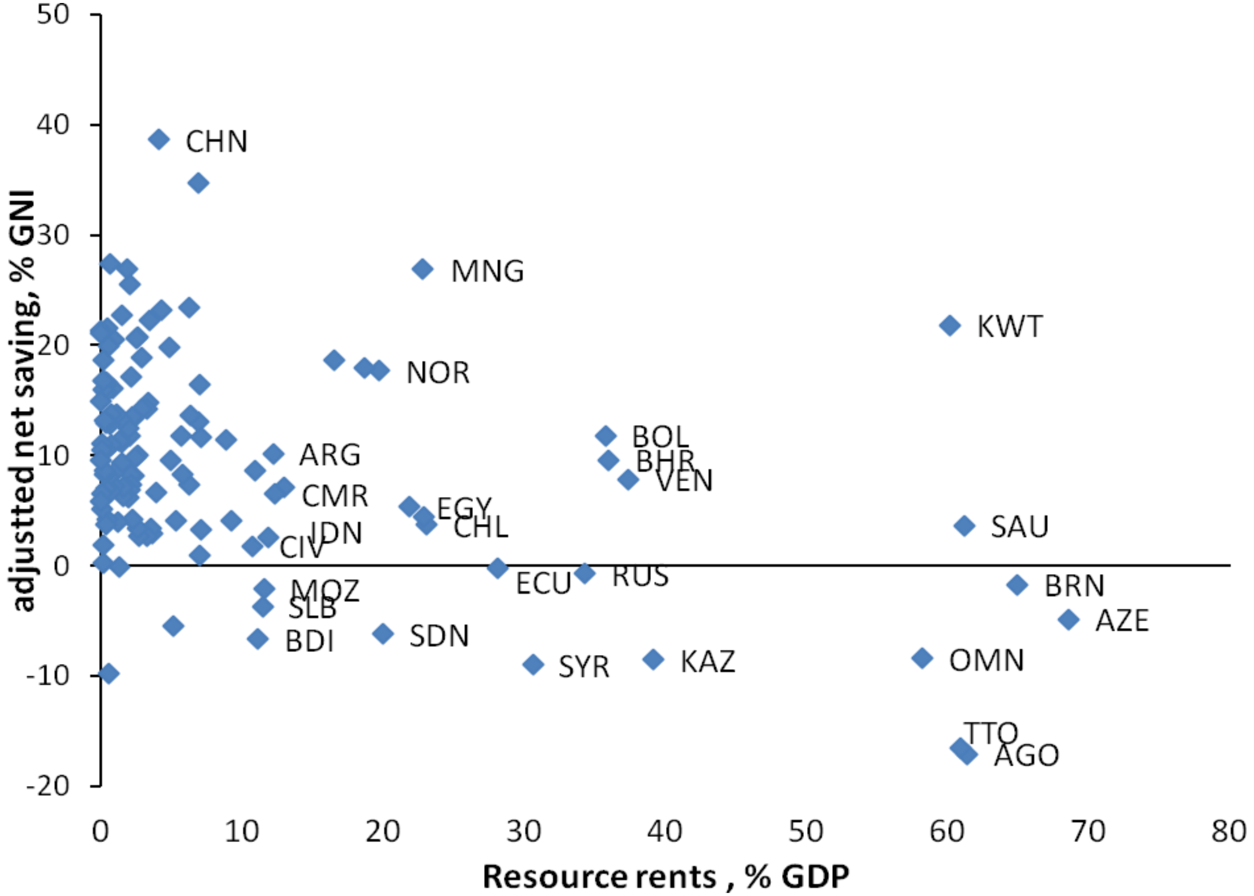
- Current poverty
- Citizens need to see benefits of resources – not just accruing to elite.

Arguments for saving

- Inter-generational equity
- Capital scarcity – physical and human
- Some investments hit both – health, education; conditional cash transfers.

- ***International experience*** has been too little saving
  - Success stories have saved a lot – in domestic assets (Malaysia, Indonesia, Thailand) and/or foreign funds (Norway)
  - Nigeria: real saving -30% GDP

II: Saving and spending



Adjusted net savings, excluding particulate emission damage (% of GNI)

II: Saving and spending

2) Need for effective investment plans

Capital rich: Norway: 'Inter-generational fund' – foreign assets

Capital scarce: Invest in the domestic economy: infrastructure, public goods, health and education

But, domestic investment hampered by lack of 'absorptive capacity':

- Congestion and bottlenecks
- Higher investment means higher prices not larger quantities

Reduce absorptive capacity constraints by:

- Having procedures for investment appraisal
- Build up spending slowly
- Being open to trade and FDI
- Economic flexibility – easy entry of new firms
- Anticipating and fixing bottlenecks – 'invest to invest'

II: Saving and spending

3) Decouple domestic spending from revenue

The timing of efficient investment / spending will in general be different from the timing of revenues:

Volatility:

- Need offshore ‘Stabilisation Fund’ in which to deposit revenues when price is high, withdraw when price is low

Absorptive capacity:

- Need offshore ‘Parking Fund’: if efficient domestic investments are not yet available, ‘park’ funds abroad until they are.

II: Saving and spending

Implementation:

Intense pressure on government to spend: legitimate claims of spending ministries – and illegitimate demands.

How to counter competing demands?

- Manage expectations: Avoid hard to reverse long run commitments (civil service pay increases)
- Strong Finance Ministry that can adjudicate claims
- Fiscal rules: legislate where revenues go

  Mixed experience

  - Norway: very conservative (only spend interest on fund)
  - Chile: Place in stabilisation fund if revenue > forecast of 'normal ' revenue:
  - Nigeria: Excess Crude Account:

  Rules have some commitment value
  but can mean that funds are passed from prudent to imprudent leaders

- Transparency, scrutiny by informed citizenry

II: Saving and spending

Summary:

- ***Maintain high domestic investment rate***
- ***Raise effectiveness of public spending***
- ***Supporting role of foreign assets***
    1) Shield from price volatility: Stabilization fund
    2) Decouple spending from revenue: Parking fund

III: The private sector; diversification & Dutch disease

Growth will come from using resource revenues to raise private sector investment and job creation.

- Opportunity to improve enabling environment
  - Infrastructure, education, access to capital, business environment
  - Can offset damage due to ‘Dutch disease’ (exchange rate appreciation making other sectors less competitive)
  - Diversify – move away from resource dependence

- Opportunity to invest in white elephants…….
  - Risks in targeting particular sectors
  - Risks in downstream processing: comparative advantage determined by skills of people not availability of resource.
  - Follow commercial principles in making commercial investments

Concluding comments

- Resource revenues are a means to an end
  - Want to end up ***not*** dependent on resources

- Downside risks
  - Resources destabilize economy
  - Resources lead to unsustainable spending commitments
  - Resources damage other sectors
  - Resources corrupt institutions

- Best practise now reasonably well understood
  www.naturalresourecharter.org

- Heavy demand on institutions and policy makers to get it right