Resource Markets, Resource Curses and Market-Oriented Reforms

Lecture 7

Petar Stankov

petar.stankov@gmail.com

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Outline

1. The Dutch Disease
2. Resource Independence and Market-Oriented Reforms
3. Oil Prices, Supply-Side Shocks and Policies

Dutch Disease

A typical chronology

1. Resource discovery (point resources), typically an extracting industry
2. Export growth
3. Resource export revenues –> foreign currency inflow –> higher demand for the domestic currency
4. Domestic currency appreciation –>
5. Loss of competitiveness
6. Exports from all other industries shrink
7. Growth suffers

Example: The Netherlands in the 1970s: tulips worth 10 guldens in Jan. 1970 are £6.6 –> by Dec. 1979 are £11.7 on the London flower market

In essence: resource production crowds out potentially more profitable activity in the economy

Dutch Disease

Examples from Sachs and Warner (1995)

Table 2. Growth Rates of Six Oil-Economies Not In Our Sample

Bahrain	1975-1988	-1.2633
Iraq	1970-1987	-1.8761
Kuwait	1980-1989	-8.0123
Oman	1970-1989	0.6910
Saudi Arabia	1970-1989	-0.6820
United Arab Emirates	1980-1989	-6.1937
Average		-2.8894

Source: Penn World Tables, version 5.6 (update of data in Summers and Heston, 1991).

Overall: no evidence that proceeds from the extracting industries can be used productively

Dutch Disease
Complications

1. Economy increasingly dependent on the extracting industry –> economic and political influence of the people close to the industry grows
2. Political favors allocated to the people close to the industry, resources shifted towards the extracting industry
3. Domestic economic policies distorted to help the extracting industry grow even bigger (after all, it is the one on which the economy depends now)
4. Economic decline because of lack of focus on competitiveness of other industries, especially in times of declining resource prices
5. Economic stagnation + non-democratic regimes

Examples: Zambia (copper), Russia (many resources), *Angola* (diamonds), *Sierra Leone* (diamonds, gold), *Democratic Republic of Congo* (minerals), Nigeria (oil)

1. civil conflict (opposition wants in the game): Angola, Sierra Leone, DRC
2. debt defaults (resource rich countries borrow easier): Iraq, Nigeria, Mexico, Venezuela

How to address the resource curse?

- hoard the cash from vested interests
- do not distort the rest of the economy

A worldwide comparative study of growth: "In the past 30 yrs the fastest growing economies were the resource-poor Korea, Taiwan, Hong Kong, Singapore..."

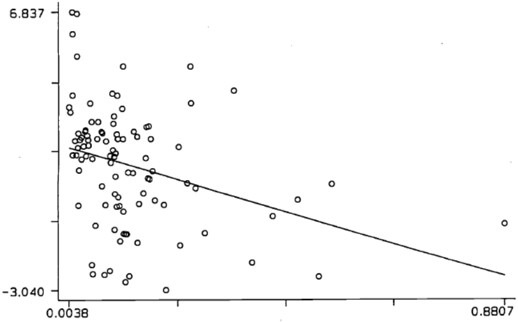


Figure 1. The simple association between growth per-capita between 1970 and 1989 (vertical axis) and the share of natural resource exports in GDP in 1971 (horizontal axis). The regression line has a slope of -5.2 and a t-ratio of -3.3.

Resource Curse

Evidence from Sachs and Warner (1995)

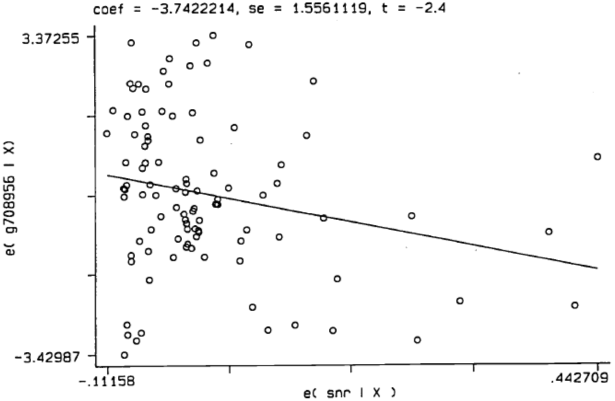


Figure 3. The partial association between growth per-capita between 1970 and 1989 (vertical axis) and the share of mineral production in GDP in 1971 (horizontal axis). The regression controls for initial income and SOPEN, and is reported as regression 3.2 in table 3.

1. Norway, Chile: National Resource Proceeds Fund
2. Spending is done gradually and if possible, wisely:
    - DO NOT subsidize/compensate the declining industries
    - improve the competitive environment and rule of law: doing business reforms, education, infrastructure

The Curious Case of Botswana

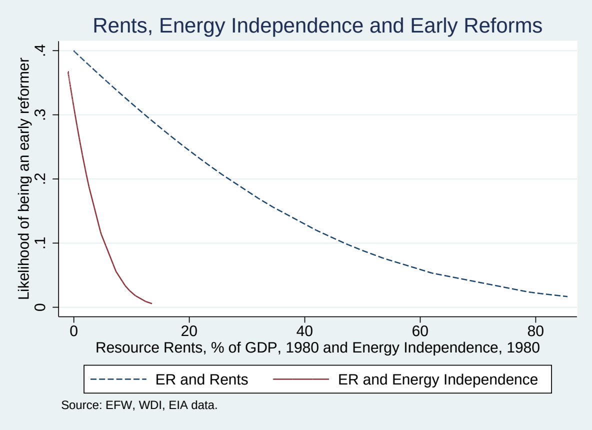
A diamond-rich country on its way to riches

1. Independence from Britain in 1965
2. first independent president creates a national wealth fund (fairly distributing proceeds to potentially conflicting tribes)
3. artificially slowing down the extraction of diamonds to be able to spend the proceeds wisely
4. funded projects were ranked by their economic benefits
5. outsourced the actual extraction to a foreign private company (De Beers) – an incentive-compatible contract
6. recently, using bargaining power to make De Beers open local operations: sorting, cutting and polishing diamonds

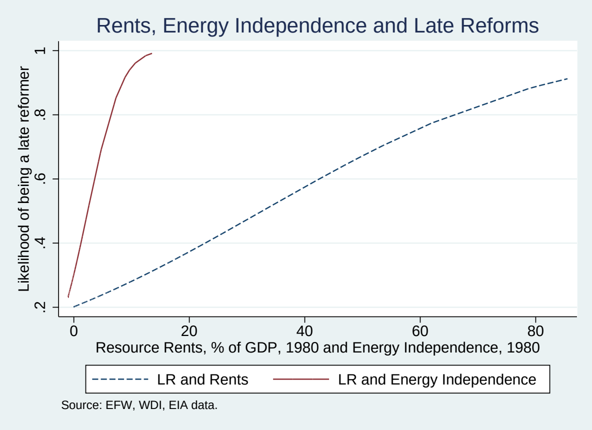
$\Rightarrow$ One of the fastest growing economies in the world

Rents, Resource Independence and Reforms

Who Reforms Early? – Stankov (2010)



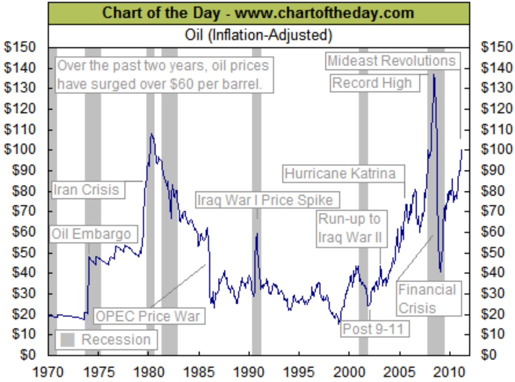
What is the link between being resource independent and reforming early?



What is the link between being resource independent and reforming late?

Oil Prices and Supply-Side Shocks

Why the recessions in the 1970s?



Using the AD-AS framework, can we explain the policies that followed the two oil shocks? What are the appropriate measures to deal with the changes in Y? Can we attribute the market-oriented reforms in Eastern Europe during the 1990s to the oil shocks?

Further reading

1. *** Sachs, Jeffrey D. and Andrew M. Warner, (1999). The Big Rush, Natural Resource Booms And Growth, *Journal of Development Economics*, 59(1), 43-76. (**Only intro and conclusions**) [or NBER WP No. 5398]
2. Beattie, Alan, (2009). *False Economy. A Surprising Economic History of the World.* Riverhead Books, New York, NY. [Chapter 4: Natural Resources: Why are Oil and Diamonds More Trouble than they are Worth?]
3. Stankov, Petar, (2010). Deregulation, Economic Growth and Growth Acceleration. *CERGE-EI Working Paper No. 424* [p.12-14]