Reformulating the Resource Curse: Policy Implications for Trinidad and Tobago

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1. The political basis of revenue deployment
2. From resource curse to rent curse
3. A political economy theory of rent cycling
4. Elite incentives and T+T political economy
5. Some policy implications

1.1 THE POLITICAL BASIS OF RENT DEPLOYMENT

1) **The Resource Curse is an intense form of a broader Rent Curse**

a) Other windfall income streams can replicate symptoms of the resource curse, notably:

(i) Foreign aid (geopolitical rent)

(ii) Government changes in relative prices (regulatory rent)

(iii) Remittances (a form of labour rent)

b) Political pressure shapes the policy that drives development

2) **Mineral economies like T+T risk an extreme form of the rent curse with all its political and economic distortions**

1.2 THE POLITICAL BASIS OF RENT DEPLOYMENT

3) Rent cycling theory explains the curse and advises on policy:

a)Basic premise: Three key rent properties (size relative to GDP + volatility + dispersal across economic agents) systematically:

(i) Shape elite incentives, which

(ii) Mould the economic policies, that

(iii) Drive the long-term political economy trajectory

b) High rent triggers contests for its capture that distort the economy but low rent incentivises the elite to grow GDP

4) To improve rent deployment outcomes, government policy in hydrocarbon-driven economies like T+T should shrink scope for elite rent capture by converting the high + concentrated rent flow into a smaller + more dispersed rent flow

Table 1 Stylised rent stream properties and predicted political economy impacts, by rent source

	Concentrated natural resource rent	Diffuse natural resource rent	Regulatory rent	Remittances (labour rent)	Foreign aid (geopolitical rent)
Rent stream properties					
Scale (% GDP)	8-20+	5-15	5-20+	2-10	2-10+
Degree of rent concentration	High	Low	High	Low	High
Volatility (Standard Deviation)	High	Moderate	Moderate	Moderate	Low
Potential rent impacts: economic					
Dutch Disease effects	High	High	Moderate	Moderate	High
Market repression + corruption	High	Low	High	Low	Equivocal
Investment efficiency	Declining	High	Low	High	Equivocal
GDP growth	Decelerating	Rapid	Decelerating	Moderate	Equivocal
Potential rent impacts: political					
Self-reliant social capital	Low	High	Low	Moderate	Equivocal
Proliferation of social groups	Constrained	High	Constrained	High	Equivocal

2. FROM RESOURCE CURSE TO RENT CURSE

1) Sachs + Warner triggered systematic statistical research

a) 1970-89 data show Dutch disease drove resource curse:

2) Acemoglu et al.: institutions moderate resource curse effects

a) Tropical colonies unhealthy for European settlement: evolved extractive institutions that foster resource curse. Temperate colonies could be settled and evolved inclusive institutions

3) Glaeser et al. rightly relegate institutions to secondary status compared with economic policy and human capital accumulation

4) Schlumberger demonstrates that institutions bend to accommodate elite aims rather than constrain those aims

5) The statistical analysis is contradictory because it neglects:

a) Other rent streams can replicate some curse symptoms

b) A policy learning curve renders curse non-deterministic and time-variant

Require a more nuanced approach such as country case studies set in the theoretical framework afforded by rent cycling

3.1 A POLITICAL ECONOMY THEORY OF RENT CYCLING

1) **<u>Low-rent</u> motivates the elite to grow the economy: provide public goods + competitive markets. Low rent model yields high-rent counterfactual**

a) Growth incentives align the economy with its comparative advantage which with low-rent lies in labour-intensive export industry

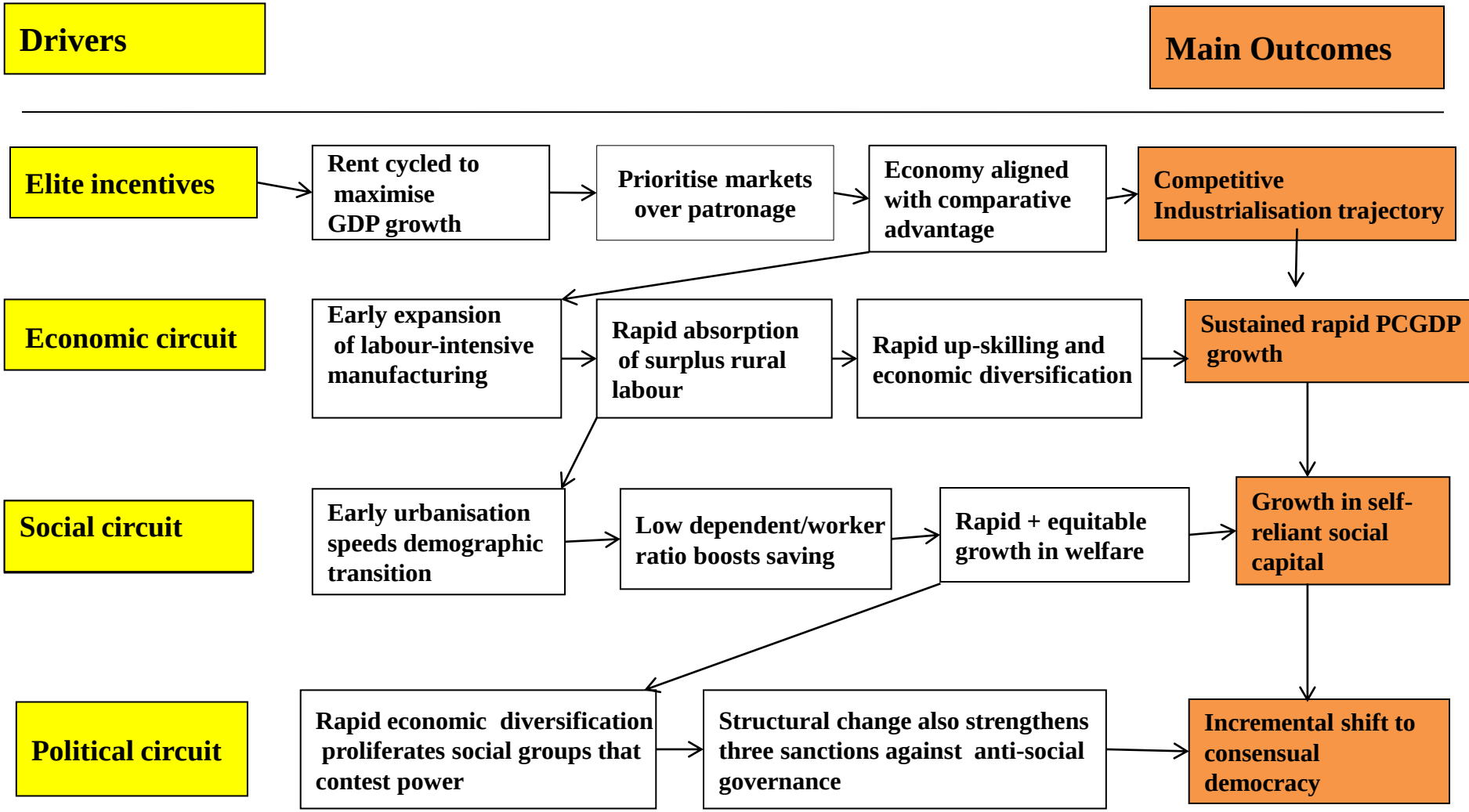
b) Early industrialisation quickly removes surplus labour + drives diversification + accelerates the demographic transition to boost PCGDP

c) Rapid + equitable economic growth and speedy structural change proliferate self-reliant social groups that contest economic/political power

d) Structural change also strengthens 3 sanctions against anti-social governance to give incremental political maturation:

i) Reliance on taxes (not rent) demands fiscal accountability
ii) Competitive urbanisation fosters self-reliant social capital
iii) Businesses lobby for safeguards to protect returns to investment

Low Rent Competitive Industrialisation Model as a Counterfactual for High Rent Situations



3.2 A POLITICAL ECONOMY THEORY OF RENT CYCLING

2) <u>High and concentrated rent</u> motivates elite to channel rent for immediate and often personal gain at the expense of markets so GDP growth stalls

a) Rent extraction for patronage deflects economy from its comparative advantage and boosts Dutch Disease effects that:

(i) Cut investment efficiency

(ii) Slow GDP growth

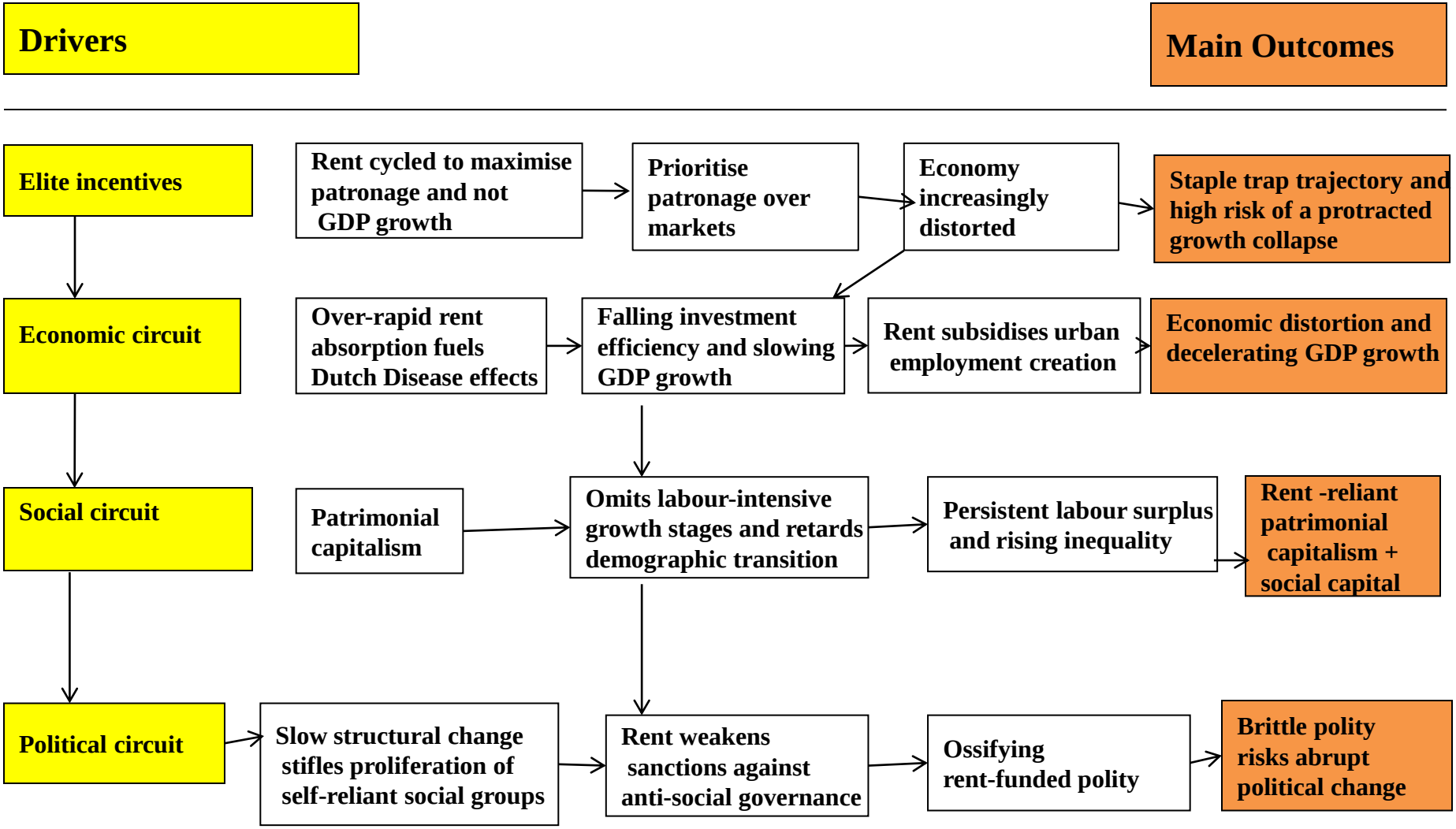
(iii) Retard structural change

b) Rent seeking consolidates a patrimonial form of capitalism + also slows the demographic transition which depresses the saving rate c.f. low rent

c) Retarded structural change delays the proliferation of self-reliant social groups able to contest political and economic power of elite

d) Rent recipients resist growth-boosting economic reform because it cuts scope for rent-seeking. This exacerbates the risk of a growth collapse

High Rent Staple Trap Model



3.3 A POLITICAL ECONOMY THEORY OF RENT CYCLING

3) Four conditions heighten the risk of maladroit rent deployment

a) Concentrated rent (as with capital-intensive mining)

b) Statist strategy (boosts scope for government intervention)

c) Ethnic diversity (associated with economic under-performance)

d) Democracy, especially if youthful, (favours targeted expenditure (projects) over universal public goods (heath care and education))

4) However, after Boserup, a growth collapse should self-correct:

a) A growth collapse retards the demographic transition, so high population growth persists and steadily cuts rent/head

b) Falling rent shrinks scope for rent-seeking, which

c) Automatically shifts elite incentives from extracting rent towards wealth creation, which restores GDP growth (providing foreign aid (geopolitical rent) does not sustain rent seeking)

4.1 RENT, ELITE INCENTIVES AND THE T+T POLITICAL ECONOMY

1) Economic policies for managing revenue windfalls are well-known:

a) Convert depleting finite asset into alternative forms of capital
b) Match rate of rent absorption to domestic absorptive capacity
c) IMF: follow permanent income hypothesis for sustainable fiscal policy

2) But the economic prescriptions say little about managing the <u>political</u> pressures for over-rapid domestic rent absorption:

a) Most rent-rich governments absorb rent too rapidly so they ignite Dutch Disease effects, which impede economic diversification.

b) Substitute rent for taxation + subsidise fuel + urban jobs in (inefficient) industry and bureaucracy: allocate rent via patronage rather markets

c) Critically: much of workforce in high-rent economies is insulated from competitive pressure to boost productivity so raising PCGDP depends on expanding rent, which **is ultimately unsustainable = rent addiction**

Table 2 PC GDP growth, developing regions and T+T 1961-2008: T+T has ridden its luck

Source: World Bank (2009)

	1961-70	1971-80	1981-90	1991-2000	2001-08
World	3.1	2.5	1.0	1.3	1.7
MENA oil exporters	5.8	-0.2	-1.6	-5.9	3.4
East Asia and Pacific	4.3	3.6	2.5	6.4	8.0
Latin Am. + Caribbean	2.7	2.3	0.5	1.7	1.5
Trinidad and Tobago	3.4	4.2	-3.3	2.6	7.2
Sub-Saharan Africa	1.8	1.6	0.2	-0.4	2.5
South Asia	2.0	0.7	3.2	2.7	5.4

4.2 RENT, ELITE INCENTIVES AND THE T+T POLITICAL ECONOMY

3) T+T 1973-82 hydrocarbon windfalls high at 35-39% of Non-mining GDP (cf. 59% of NMGDP 2004-08). Deployed rent for state-led RBI.

a) Prioritised steel, which even if well-implemented, offered far less return per unit of gas deployed than LNG alternative (rejected). Joint-venture petrochemicals more profitable

b) Boosted public consumption that fed rent-seeking via subsidies for farming, energy consumption and low personal tax rates

c) Over-rapid rent absorption caused inflation and Dutch disease effects, despite initial caution and pioneering rent transparency

d) Negative oil price shock caused a protracted GDP growth collapse 1982-1993 that cut incomes by 1/3 and destabilised politics

4.3 RENT, ELITE INCENTIVES AND THE T+T POLITICAL ECONOMY

4) GDP growth was reignited from 1993 by IMF-backed depreciation + LNG export expansion, NOT diversified private sector investors

5) Post-2003 boom shows some lessons learned from 1973-93:

a) 2/3 windfall appears to have been saved, part by the private sector and part by the government in the Heritage Saving Fund

b) 1/3 windfall absorbed domestically: half consumption and half investment, but:

(i) Consumption expanded subsidies and kept government spending above the average level for T+T's PCGDP

(ii) Tripled public investment (relatively inefficient) to 12% of GDP to offset unusually low private investment

c) By 2010 annual fiscal deficit 3X the 4-8% of Non-mining GDP that the IMF estimates T+T hydrocarbon rent can sustain indefinitely

Table 3 Summary of Estimated Domestic Absorption of T+T 2004-08 Energy Windfall (% Non-mining GDP)

Total windfall	**59.3**
Extra consumption	**10.2**
Private	**4.8**
Public	**5.4**
Extra investment	**10.4**
Private	**-1.7**
Public	**12.1**
Extra Saving	**38.7**

4.4 RENT, ELITE INCENTIVES AND THE T+T POLITICAL ECONOMY

6) T+T political parties compete to channel rent to voters rather than to shift from rent-driven growth to productivity-driven development

a) The real exchange rate strengthened by one-third through 2000s

b) The windfall fed rent-seeking that continued to favour trade unions, middle class consumers and businesses

c) T+T governance indices deteriorated 1998-2010, yet PCGDP rose

7) T+T needs to switch to productivity-driven growth:

a) IMF, IADB and World Bank seem to be the principal backers of productivity-driven growth in T+T, not the national political parties

b) Economic reform needs a political strategy to:

(i) Cut domestic rent absorption and scope for rent-seeking

(ii) Establish an Early Reform Zone (ERZ) to help build a pro-growth political coalition for a dynamic market economy

5.1 OVERVIEW: SOME POLICY IMPLICATIONS

1) The resource curse is part of a more general rent curse

a) Hydrocarbon rent especially difficult to manage because is usually high % of GDP, volatile + concentrated on a few economic agents

b) Rents from cropland and remittances are smaller and dispersed, facilitating GDP growth. **Key policy insight: Low and dispersed rent limits scope for elite rent-seeking and facilitates development**

2) Despite government caution and transparency T+T mismanaged the 1973-82 oil booms and absorbed the rent too fast:

a) State-led resource-based industry gave poor return

i) Subsidies entrenched rent-seeking

ii) IMF reform + LNG revived GDP growth after 1982-93 collapse

b) Rent dependence/ rent addiction was entrenched and persisted

5.2 OVERVIEW: SOME POLICY IMPLICATIONS

3) Applied policy lessons from 1973-93 boom-bust cycle to post-2003

a) Saved more of windfall (2/3) and avoided statist policies,

b) But: (i) Tripled public sector investment share of GDP

(ii) Expanded undesirable and distorting subsidies

(iii) Public sector deficit share of NMGDP = 3X sustainable level

4) Political parties compete to channel rent to win votes rather than to grow a productivity-driven economy. Need to:

a) Lower domestic rent absorption (and lower the exchange rate)

b) Remove rent-backed subsidies: eg Iran per capita compensation

c) Construct an Early Reform Zone to encourage dynamic domestic + foreign firms to invest in competitive export businesses

5.3 SOME POLICY IMPLICATIONS

5) Rent cycling theory suggests improved development in mineral-driven economies needs to transform the large, volatile and concentrated rent flow into a smaller, stable and more dispersed flow so as to:

(i) Switch elite incentives from rent-seeking to growing the economy

(ii) Align public expenditure with permanent income hypothesis to achieve sustainable rate of domestic rent absorption

(iii) Reduce government role in allocating rent: more PC rent allocation

(iv) Boost government reliance on personal taxation, rather than rent

(v) Expand competitive firms in ERZ producing energy-related goods and services as basis for later product and geographical diversification