Reformulating the Resource Curse: Policy Implications for Trinidad and Tobago

Richard Auty (Lancaster University)

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
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

<table>
<thead>
<tr>
<th>Rent stream properties</th>
<th>Concentrated natural resource rent</th>
<th>Diffuse natural resource rent</th>
<th>Regulatory rent</th>
<th>Remittances (labour rent)</th>
<th>Foreign aid (geopolitical rent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scale (% GDP)</td>
<td>8-20+</td>
<td>5-15</td>
<td>5-20+</td>
<td>2-10</td>
<td>2-10+</td>
</tr>
<tr>
<td>Degree of rent concentration</td>
<td>High</td>
<td>Low</td>
<td>High</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Volatility (Standard Deviation)</td>
<td>High</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Low</td>
</tr>
</tbody>
</table>

Potential rent impacts: economic

- Dutch Disease effects: High
- Market repression + corruption: High, Low
  - Concentrated: Low
  - Diffuse: High
  - Regulatory: High
- Investment efficiency: Declining, High
- GDP growth: Decelerating, Rapid

Potential rent impacts: political

- Self-reliant social capital: Low, High
- Proliferation of social groups: Constrained, High
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) **Low-rent** 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

Drivers

Elite incentives
Rent cycled to maximise GDP growth

Economic circuit
Early expansion of labour-intensive manufacturing
Rapid absorption of surplus rural labour
Rapid up-skilling and economic diversification
Sustained rapid PCGDP growth

Social circuit
Early urbanisation speeds demographic transition
Low dependent/worker ratio boosts saving
Rapid + equitable growth in welfare
Growth in self-reliant social capital

Political circuit
Rapid economic diversification proliferates social groups that contest power
Structural change also strengthens three sanctions against anti-social governance
Incremental shift to consensual democracy

Main Outcomes
Competitive Industrialisation trajectory
2) **High and concentrated rent** 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

Drivers

- Elite incentives
  - Rent cycled to maximise patronage and not GDP growth
- Economic circuit
  - Over-rapid rent absorption fuels Dutch Disease effects
  - Falling investment efficiency and slowing GDP growth
- Social circuit
  - Patrimonial capitalism
- Political circuit
  - Slow structural change stifles proliferation of self-reliant social groups

Main Outcomes

- Economy increasingly distorted
  - Rent subsidises urban employment creation
  - Stabil trap trajectory and high risk of a protracted growth collapse
- Rent weakens sanctions against anti-social governance
  - Persistent labour surplus and rising inequality
  - Ossifying rent-funded polity
  - Brittle polity risks abrupt political change
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 (health 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 political 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


<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>3.1</td>
<td>2.5</td>
<td>1.0</td>
<td>1.3</td>
<td>1.7</td>
</tr>
<tr>
<td>MENA oil exporters</td>
<td>5.8</td>
<td>-0.2</td>
<td>-1.6</td>
<td>-5.9</td>
<td>3.4</td>
</tr>
<tr>
<td>East Asia and Pacific</td>
<td>4.3</td>
<td>3.6</td>
<td>2.5</td>
<td>6.4</td>
<td>8.0</td>
</tr>
<tr>
<td>Latin Am. + Caribbean</td>
<td>2.7</td>
<td>2.3</td>
<td>0.5</td>
<td>1.7</td>
<td>1.5</td>
</tr>
<tr>
<td>Trinidad and Tobago</td>
<td>3.4</td>
<td>4.2</td>
<td>-3.3</td>
<td>2.6</td>
<td>7.2</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>1.8</td>
<td>1.6</td>
<td>0.2</td>
<td>-0.4</td>
<td>2.5</td>
</tr>
<tr>
<td>South Asia</td>
<td>2.0</td>
<td>0.7</td>
<td>3.2</td>
<td>2.7</td>
<td>5.4</td>
</tr>
</tbody>
</table>
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>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total windfall</td>
<td>59.3</td>
</tr>
<tr>
<td>Extra consumption</td>
<td>10.2</td>
</tr>
<tr>
<td>Private</td>
<td>4.8</td>
</tr>
<tr>
<td>Public</td>
<td>5.4</td>
</tr>
<tr>
<td>Extra investment</td>
<td>10.4</td>
</tr>
<tr>
<td>Private</td>
<td>-1.7</td>
</tr>
<tr>
<td>Public</td>
<td>12.1</td>
</tr>
<tr>
<td>Extra Saving</td>
<td>38.7</td>
</tr>
</tbody>
</table>
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
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) 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