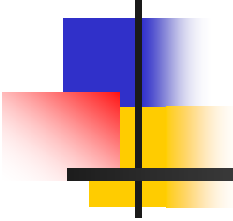


Natural Resource Funds & the Macro-Economics of Rentier Economies: Application to Trinidad and Tobago



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THE RESOURCE CURSE

- “ ALL IN ALL I WISH WE HAD DISCOVERED WATER.”
- Sheik Yamani, former Oil Minister, Saudi Arabia



CONTENT OF PRESENTATION

- 1 Definition of Macro-Economics, Economic Rents, Rentier Economy, State and Society;
- 2. Macro-Economics of Rentier Economies;
- 3. Macro-Economics of Transformation of Rentier Economies and States;



Introduction contd

- 4. Application to T&T
 - A: Role of A Hydrocarbon Fund;
 - B: Why a Fund is a necessary but not sufficient condition for rising to the key challenges;
 - C: What then is the sufficient condition?



Definition of Economics

- Own Def: study of how societies organise their material reproduction with the intention of thereby advancing policy proposals for improving the efficiency with which these material needs are met.



Wonnacut& Wonnacut Def

- The study of how people make a living, how they acquire the food, shelter, clothing and other material necessities and comforts of this world. It is the study of the problems they encounter, and of the ways in which these problems can be reduced.”



Definition of Macro-Economics

- Own Generic Def of macro-economics as;
- “ The study of the functioning of the economy as a whole with the objective of identifying key variables susceptible to Governmental economic policy manipulation in the interest of achieving national goals of full employment and equity(econ,social,pol &envtal) through creation and reproduction of an optimally diversified, globally competitive economy:ie. Achieving sustainable development;



Def Macro-Econs contd

- This macro-econ Definition begs 3 Qs:
- A. Does a macro-econ exist in Caribbean-type econs in the first place given openness of economy and dependence on external demand for exports to generate internal growth?;
- B. Do national economic policy levers exist to control any key identified macro-economic variables?;



Macro-Econ Question 3

- C. and certainly begs Q. of use of conventional Keynesian, demand-side macro-policy instruments evolved for metropolitan economies utilising Keynesian identity:
- $Y = C + I + G + X - M$;
- As opposed to say $E = X - M + r$
- Where E =employment; r =residential sector



2 kinds of macro-economic models can be developed:

- 1. To explain why economy how economy works including its not achieving goals of full employment, equity, globally competitiveness;
- 2. Transformation model which would identify key variables which need to be impacted upon in order to achieve desired goals;
- Egs of Caribbean-specific type 1 macro-economic models(with some clues to type 2 macro-economic transformation models) are:
The Model of plantation economy (Best/Levitt) and Open Petroleum Economy¹⁰



Caribbean macro-economic models

- Plantation Economy Model of Best & Levitt argued, for eg, that the Balance of Payments is the meaningful macro-economic variable to be acted upon in terms of national economic policy instruments.
- As a result Best has (over?) emphasised role of exchange rate in macro-econ management



Macro-Econs contd

- Dudley Seers Mechanism of Open Petroleum Economy begins by implicitly questioning the use of GDP as key indicator of economic performance showing that positive economic growth in GDP over several reasons can coincide with growing unemployment, poverty and inequality in open petroleum economies;

Seers contd



- Moreover, Seers pointed out- long before the so-called 'Dutch disease' concept was developed that in the open petroleum economy there would be distortions in wage, income and price formation to the detriment of both other sectors in the economy and, as well to longer run economic, social and political stability (conclusions not drawn obviously in the Netherlands-dutch disease-case);



Seers contd

- Seers also pointed out that the open petroleum economy will have disguised balance of payments problems (linking implicitly therefore with the Plantation economy model case for BOP as macro economy) which will manifest themselves at the end of a boom period;

-



Economic, social and political instability in such economies

- Seers also noted that Open Petroleum Econs ignore/disregard underlying social and economic inequalities in boom periods but these manifest themselves in the bust period:
- “The mechanism of an Open Petroleum Economy resembles that of a time bomb”
- Karl also has drawn a comparison between natural resource dependence and political conflict: see next slide



N Res dependence and pol conflict correlation

- ADD TERRY KARL SLIDE HERE



Critique Plantation and Open Petroleum Econ models

- Both seminal contributions but suffer from common weakness of reifying either:
- A. the 'legacy' of the founding institutional and behavioral charts of the plantation economy;
- Or: B: a 'mechanism' of the open petroleum economy;
- Thereby failing to reveal the human agency which permits reproduction of the same behaviour over repeated booms and slumps



Rentier Hypothesis

- Hypothesis being advanced is that human agency which explains reproduction of natural resource based economies is that of the Rentier Economy, State and Society



Def Natural Resource economic Rents

- 'Unearned income provided gratis by nature':
- It is the return to investment in natural resource industries beyond that necessary to cover costs and provide a normal rate of return on investment;
- It is the value inherent in the natural resource: e.g. fish stock in the case of renewable resources where the alternative to catching fish in the sea would be to grow them in ponds.



Definition Rentier Economy

- A Rentier Economy is one whose economic survival and growth is significantly dependent on economic rents generated from natural resources in particular;



Characteristics of Rentier Economy

- Beblawi sets out the following 3 key Characteristics of Rentier Economy:
 - 1. Rent is the predominant income;
 - 2. The origin of the rent is external since pure internal rent boils down to a situation of domestic payment transfers;
 - 3. A minority of the pop must be engaged in rent generation while the majority is involved in the distribution and utilization of it.



4. Oil Rentier Economies

- Oil Rentier Economy defined inter alia, as one in which “ a minority of the pop is engaged in the generation of the rent while the majority is involved in the distribution and utilization of it.”



Definition of Rentier State

- Beblawi and Luciani(1987) define Rentier State as” one substantially supported by expenditure from the state while the state itself is supported from rent accruing from abroad; or more generally an economy in which rent plays an important role.”



Definition of Rentier Society

- One in which the ruling psychology is that of seeking to identify personal and group advantage over distribution of economic rents and with little concern for transformation into a productive-oriented economy. E.g. 1970s, B.Stalin: "Mr. Divider run s/thing before the oil\$dun and the yankees go."

Application to T&T



- . Key Challenges facing T&T are:
 - To avoid the economic errors made in the two prior hydrocarbon booms of the late 1950s and 1974-1981;
 - And thereby exploit the opportunities of the present oil and gas windfalls to create a fully employed, globally competitive economy with equity.
 - REMINDER/INFORMATION ON 2 PRIOR BOOMS



The first oil boom of the 1950s

- A.N.R. Robinson shares the important bookmark(Mechanics of Ind) that there was an economic boom in the 1950s resulting largely from increased oil prod. This petered out by the turn of independence in 1962: " Independence literally came at the end of a boom and there had been no warning that the end was coming."(p.111)



Second oil boom of 1970s

- Began end of 1973 came to an end in 1981 when country saw return to Balance of payment deficits;
- However, decision taken to 'finance the adjustment' leading to squandering of US\$2.3 billion in foreign exchange reserves and borrowing of another US\$1billion between 1982-1987;
- Those who corrected predicted this outcome unless policy changed were famously labelled 'prophets of gloom and doom'



Erroneous/disastrous policies of IMF/WBank

- Embrace of IMF/World Bank stabilization and structural adjustment policies led to most vulnerable groups bearing the brunt of the adjustment and hence creating Social Debt to repay Foreign Debt.
- Seers “mechanism of open petroleum econ resembles that of a time bomb.”

MACRO-ECONOMICS OF Transformation of Rentier Economies



- Natural resource based Rentier Economies live on borrowed time given:
- depletion of non-renewable resources available for economic exploitation;
- Externally determined market demand/prices;
- Growth of substitutes;
- Internal conflict within Rentier economy resulting from the mal-distribution of these economic rents.



explaining persistence/ reproduction of Rentier Economies

- Why&How does Rentier Economy reproduce itself?
- Simple answer is that macro-economy policy interventions are inappropriate to meeting challenge of exploiting opportunity for transformation to productive-oriented economy;
- More complex answer is that the root problem lies in the nature of the Rentier psychology, society and State



T&T application contd

- Three key macro-economic issues that need to be addressed to transform the T&T Rentier Economy into a productive-oriented one:
 - 1. Hydrocarbon Fund
 - 2. Appropriate macro-economy policy;
 - 3. Institutional/Governance Reform



Transformation contd

Transforming Rentier Econs requires implementation of the MMCI rules:

- (M)aximise Value Added
- (M)easure Economic Rents
- (C)apture Economic Rents
- (I)nvest Economic Rents



Transformation cont

- Investment should include:
- Within natural resource sector itself to maximise value added & export potential independent of natural resource stock (e.g. services, foreign investment);
- In other sectors of economy to diversify productive sectors;
- In human, social and physical infrastructure



Role of a Hydrocarbon Fund in rising to the challenge

- A. Types of possible Funds;
- B. The history of such Funds since the 1950s
- C. Financing Sources for Funds;
- D. Investment Policies
- E. Withdrawal rules



A. Types of possible Funds

- Stabilization Funds to smooth path of fluctuations in price/income from natural resources;
- Heritage or Permanent Funds are Savings and Investment Funds to address inter-generational equity.
- Mixed Stabilization/Heritage Funds



A. History of Funds since 1950s

- 1950s: Kiribati (Stabilization& Savings)
- 1960s: Kuwait(Stabilization& Savings)
- 1970s: Alaska, Alberta and Kuwait: (Savings);
- 1980s: Chile(Stabiliz); Oman(Savings)
- 1990s: Oman(Stabilisation: abolished 93)
- ;Azerjaijan, Norway and Venezuela:Savings;
- 2000-2005:Algeria, Iran, Mexico,T&T(Stabiliz)
- Kazathan and T&T(Savings?)



C. Financing Sources for Funds

- Sources for financing such Funds include, in the main, income in excess of some set price from hydrocarbons;
- However, Alaska, Alberta include other natural resources including forests;
- Also Kuwait sets 10% allocation to Savings Fund whatever is price trend.



D. Investment Policies

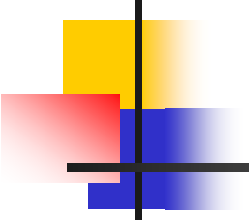
- Control of Funds vested in most instances in Ministries of Finance and Central Bank which, in some instances, create distinct institutions to manage portfolio;
- In a few instances Parliament also has oversight of investment policies.

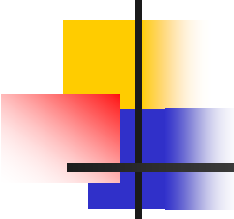


E. Withdrawal Rules

- Withdrawal rules vary in terms of extent of transparency, accountability and participation of Parliament and public in process;
- Most robust is Alaska's Permanent Fund which requires a referendum for access to the Principal in the Fund.

3. Ideal type of fund(s) for T&T?

- 
-
- Distinct Stabilization and Permanent Funds with also differing rules for access;
 - Stabilisation Fund should be accessible with Parliamentary approval;
 - Permanent Fund ought to require referendum



4. Why a fund is a necessary but not sufficient condition for rising to the key challenge

- As Davis et al have argued Natural Resource Funds may be considered 'Problems posing as Solutions'; based on their Econometric analysis of 12 oil exporting countries (5 with Funds) showing that in most instances Govt expenditure rose and fell with oil income flow



4. contd

- It is only in a few of these 12 countries that expenditure did not follow oil income flows and for those with Funds this occurred BEFORE and after the establishment of Funds.
- E.g. T&T had a Savings/Stab Fund in all but name in the last oil boom which grew to US\$2.3 billion in 1981;
- By 1987 this disappeared together with US1 billion in additional foreign borrowing being incurred.



4. contd

- Moreover, even well designed and protected Stabilization and Permanent Funds cannot, in themselves resolve the distortions caused by booming hydrocarbon earnings including the crowding out of other globally competitive production of goods and services.



4. Transforming Rentier Econ

- Three elements required in addition to Hydrocarbon Fund:
 - 1. Technical:macro-economic policy (easiest of all);
 - 2. Transforming the Rentier State to provide for real transparency, accountability and participation(a pre-requisite for technical solutions);
 - 3. Transforming the Rentier psychology of the society(a pre-requisite for Governance reform).



Technical Policy Solutions

- Modify Nat Income Accounts to measure genuine savings(ie.natural capital depreciation account);
- Sterilize windfall incomes and hence protect monetary system from inflationary&/or import pressures;
- Buttress monetary/BOP objectives through establishment of a Modified Currency Board;



Technical Solutions contd

- Fund at least fiscal contribution to national budget of hydrocarbon sector out of prior year's hydrocarbon fiscal earnings and seek to ultimately fund at least the hydrocarbon sector share from accumulated savings in hydrocarbon fund if not entire recurrent budget;



Technical Policy Solutions

contd

- Provide incentives for genuinely productive activities in the non-hydrocarbon investment
- Implement Industrial and Technology Policy to support investment choices
- Investment heavily in human resource development support of investment choices;



Transforming the Rentier State

- State is central actor in Rentier Economy.
- Transforming the Rentier State to one which is transparent, accountable and efficient is an ECONOMIC objective in that it is a pre-requisite for the technical economic objectives to be achieved.



Transforming Rentier psychology and Society

- Civil responsibility for the future beyond personal self-interest involving:
- Public education;
- Advocacy.
- Civil society rooted Governance Reform