

# The Resource Curse Economy: Focus on Russia in a Global Context

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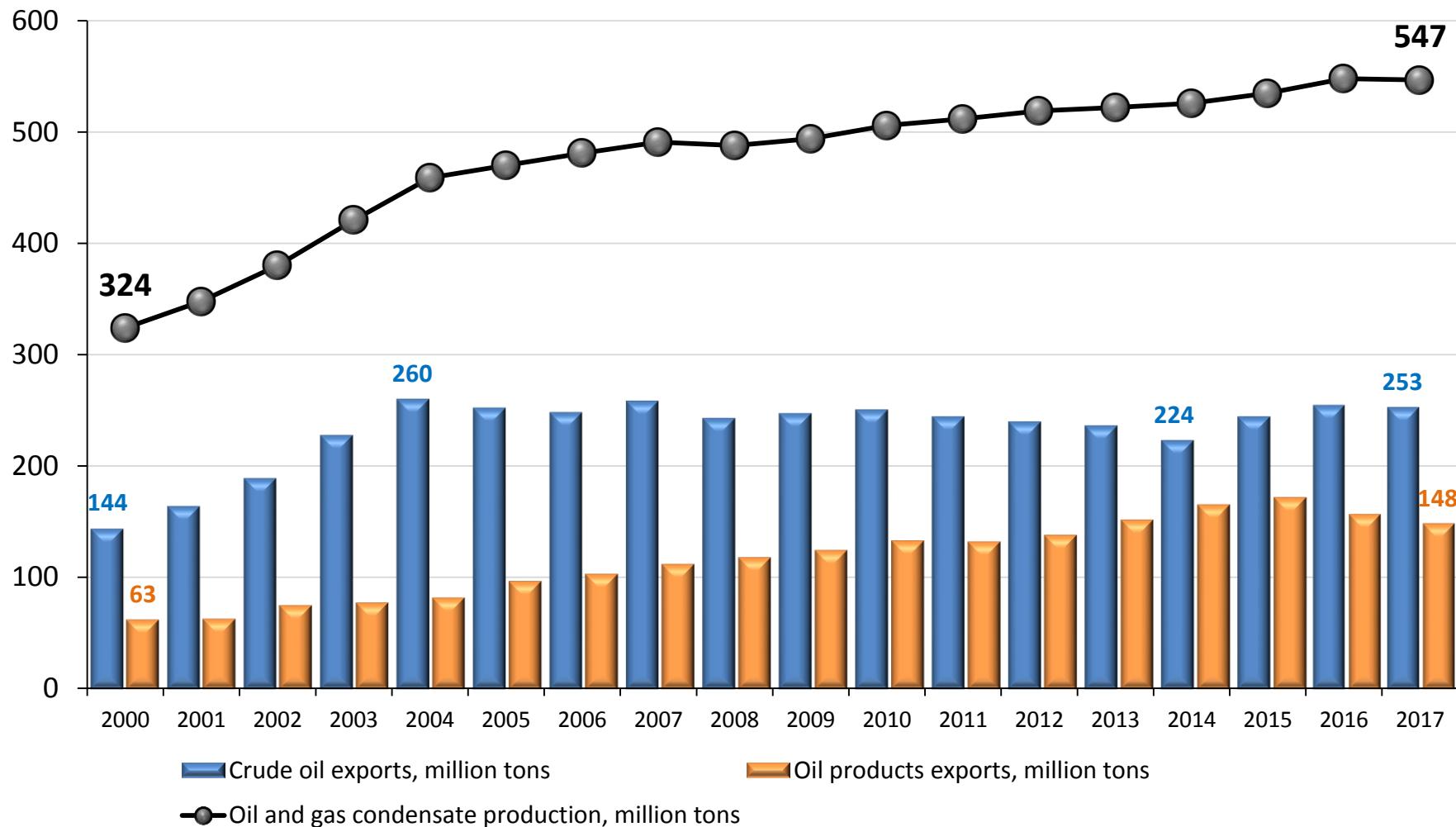
# The structure of the presentation

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- Some macroeconomic indicators of Russia in the context of resource orientation of the economy
- What is the “resource curse”?
  - Macroeconomic aspect
  - Institutional aspect
- The role of sovereign wealth funds in resource-rich countries

# Some macroeconomic indicators

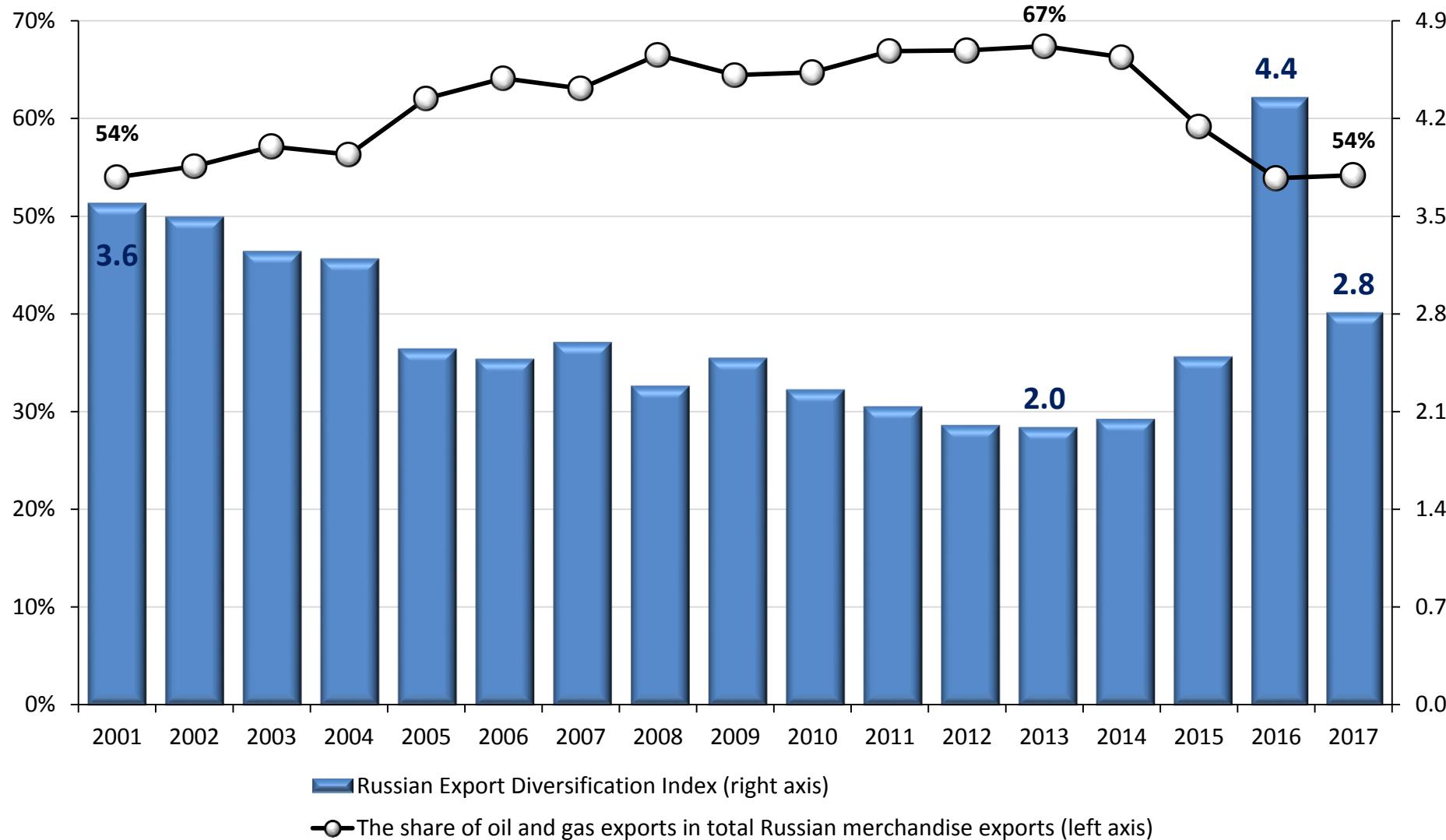
## Oil production (including condensate) and physical export of oil/oil products from Russia (2000–2017)



Source: Federal Service of State Statistics [www.gks.ru](http://www.gks.ru); Bank of Russia <http://www.cbr.ru/>

# Some macroeconomic indicators

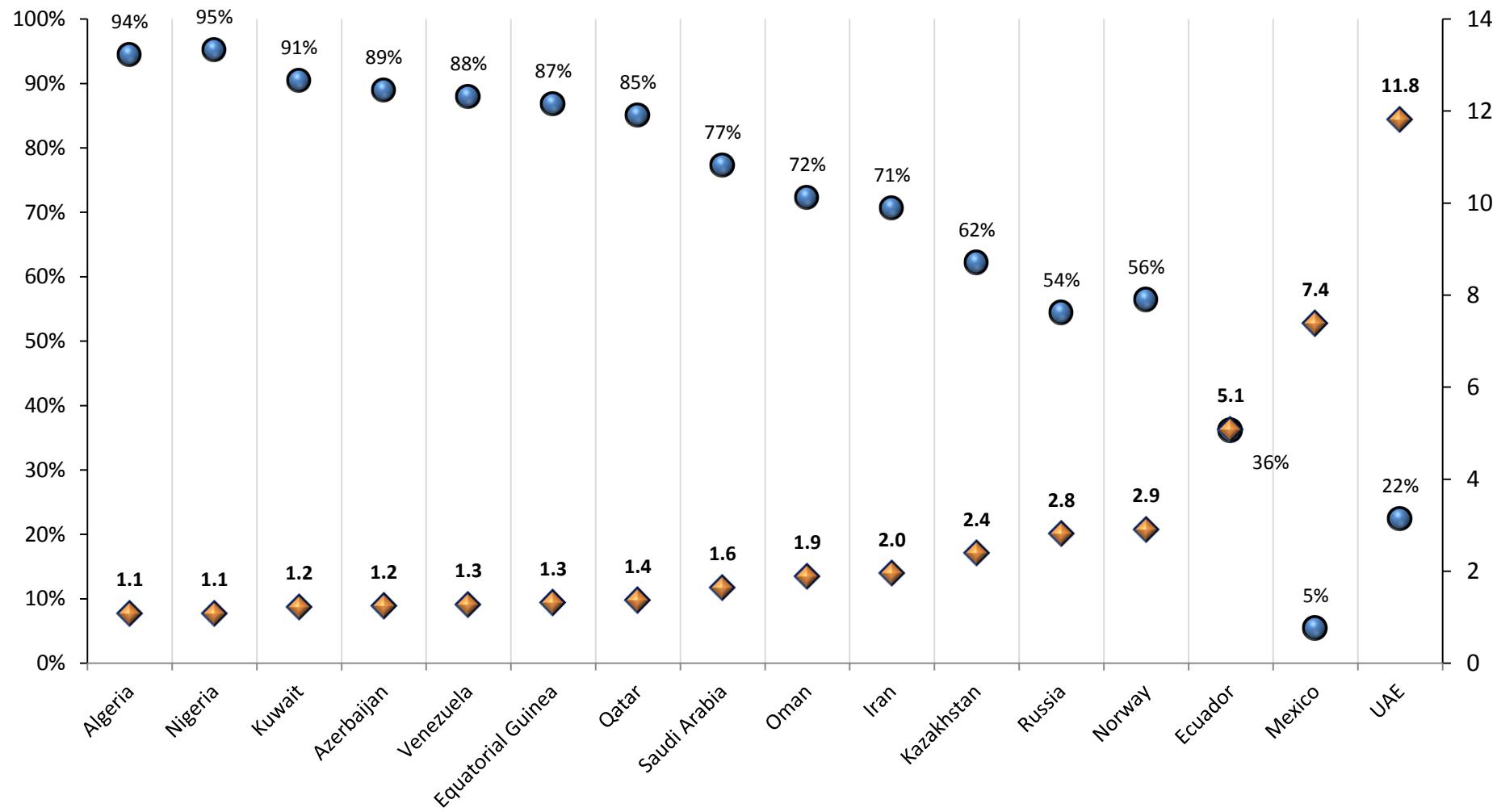
## Dynamics of the share of oil and gas exports in total exports and export diversification ratio



Source: calculations based on data from ITC Trade Map, Bank of Russia

# Some macroeconomic indicators

## Comparison with some resource rich countries (2017)



● The share of oil and gas exports in total merchandise exports (left axis)

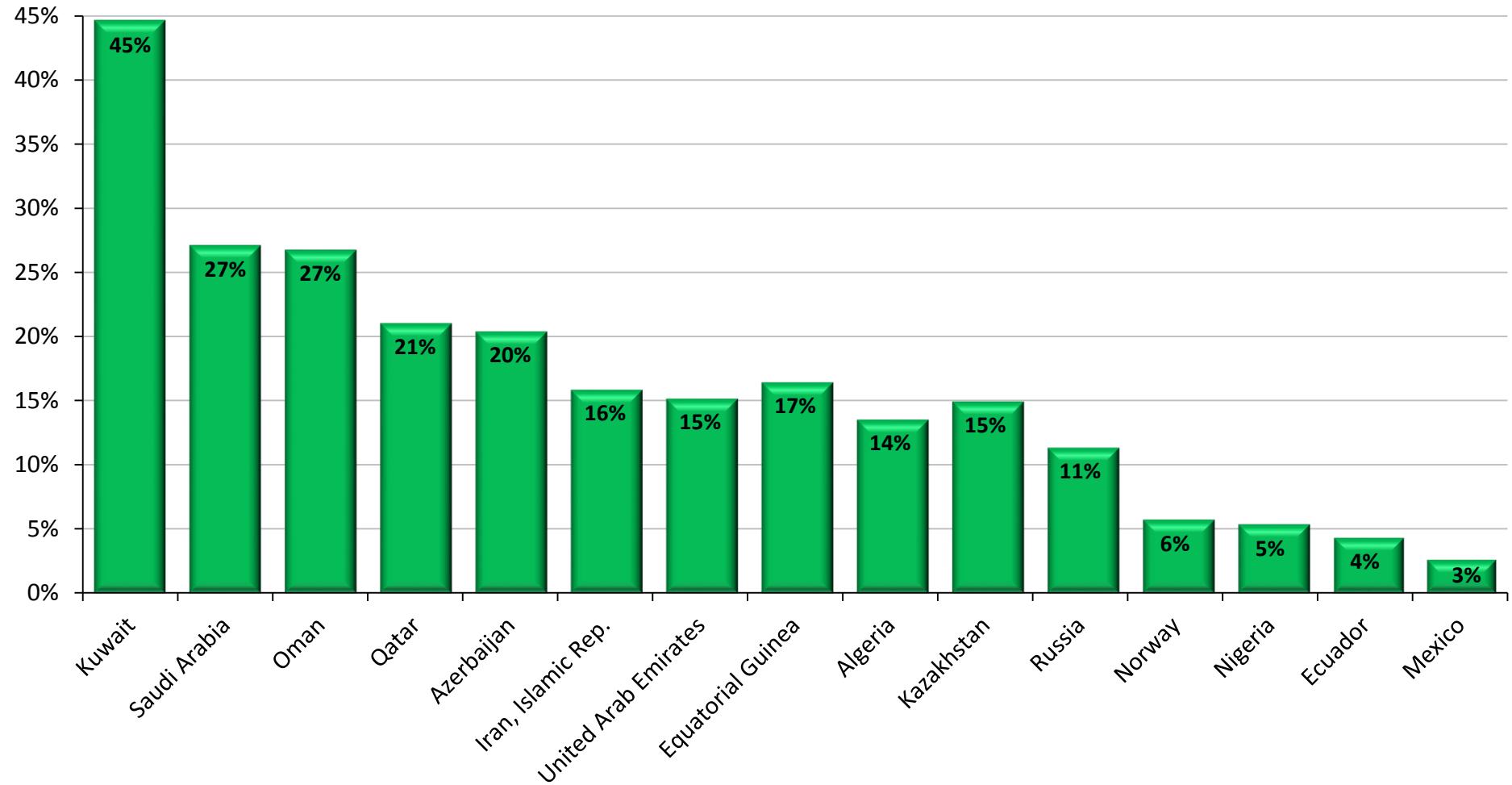
◆ Export Diversification Index (right axis)

Note: \* — HS 2709–2715.

Source: estimation based on the World Integrated Trade Solution: <http://comtrade.un.org/db>

# Some macroeconomic indicators

## Total natural resources rents (% of GDP), 2016



# Some macroeconomic indicators

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## Key findings from observations

- ✓ Since the second half of the 2000s there is stagnation of oil production. Given the fact that now oil price is quite high and it's highly unlikely that oil price increases significantly, so we shouldn't expect an increase in revenues from oil and gas exports.
- ✓ In recent years the share of oil and gas exports in total exports declined but export diversification increased.
- ✓ If we compare the share of oil and gas exports in total exports and diversification, then it turns out that Russia is not very resource dependent, close to Norway. The same follows from the analysis of the share of fuel and raw material rents in GDP.
- ✓ Thus, Russia faces typical for resource economies problems a priori, but In a less degree than the most well-known examples of oil economies.

# **Resource curse: What is the "oil needle"?**

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- ✓ **Resource curse** is not a big share of raw materials in GDP, not a big share of raw materials in exports, not a low diversification of the economy. “Resource curse” is a collection of phenomena of resource-rich countries.
- ✓ Introduction of the term — (**Auty, 1993**).
- ✓ (**Sachs J., Warner A., 1995, 1997**) drew attention to lower growth rates. Later on, similar results were obtained in (**Sala-i-Martin X., 1997**) and in many other cross-country studies of economic growth (**Mehlum, Moene, Torvik, 2006; Gylfason, 2005**). Moreover, in the researches (**Papryrakis E., Gerlagh R., 2007**) and (**Cooke C., Aadland D., Coupal R., 2007**) a similar result was obtained for growth rates of particular US states (resource-rich states really grow more slowly).

# Resource curse: What is the "oil needle"?

## Average annual rates of long-term economic growth for some resource-rich countries

| Country              | GDP growth,% to prev. year | Growth of per capita GDP, % to prev. year | Considered period    |
|----------------------|----------------------------|---|----------------------|
| Venezuela            | 2,8                        | 0,3                                       | 1961–2017 (57 years) |
| Norway               | 3,1                        | 2,5                                       | 1961–2017 (57 years) |
| Kuwait               | 3,4                        | -2,7                                      | 1966–2017 (52 years) |
| Algeria              | 3,8                        | 1,4                                       | 1961–2017 (57 years) |
| Ecuador              | 3,9                        | 1,6                                       | 1961–2017 (57 years) |
| Mexico               | 4,0                        | 1,8                                       | 1961–2017 (57 years) |
| Nigeria              | 4,0                        | 1,4                                       | 1961–2017 (57 years) |
| Iran                 | 4,3                        | 1,9                                       | 1961–2017 (57 years) |
| Libya                | 4,9                        | 3,8                                       | 2000–2017 (18 years) |
| United Arab Emirates | 4,9                        | -1,9                                      | 1976–2017 (42 years) |
| Saudi Arabia         | 5,2                        | 1,4                                       | 1969–2017 (49 years) |
| Oman                 | 8,7                        | 4,6                                       | 1966–2017 (52 years) |
| Qatar                | 9,9                        | 0,5                                       | 2001–2017 (17 years) |
| Equatorial Guinea    | 15,3                       | 10,5                                      | 1981–2017 (37 years) |

Source: World Bank, World Development Indicators <http://databank.worldbank.org/data>

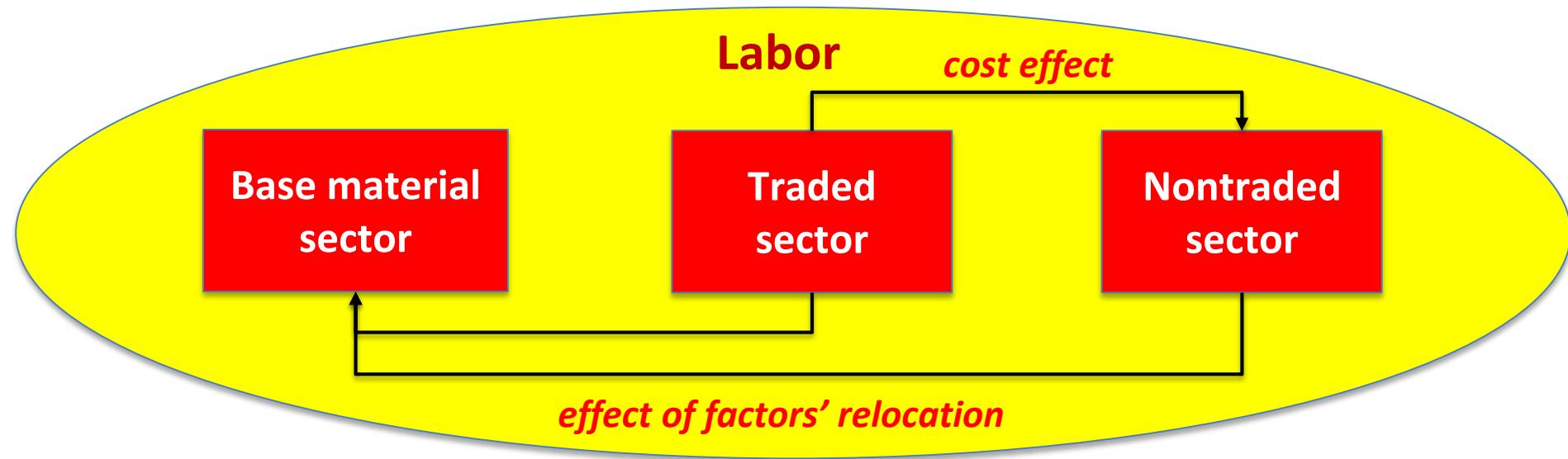
## **Resource curse: What is the "oil needle"?**

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- ✓ There is a hypothesis that the resource can “hinder” for economic development. Therefore, if a resource is in the way, we should think about of how make the economy growth at the rate which it could grow while maintaining the positive effects of resource availability.
- ✓ Unlike widespread opinion the results of these studies do not prove that resource-rich countries would live better if they got rid of resources. “Resource curse” is a negative influence of the economy’s structure on economic growth rates, but not on development level. “Resource curse” indicates the negative impact not of availability of natural resources, but of their domination in the national economy (see **Guriev, Sonin, 2008**).

# Resource curse: Macroeconomic aspect

## The "Dutch" disease: (Bruno M., Sachs J., 1982)



- ✓ What happens when the world resource price rises?
- real appreciation of money leads to the flow of resources from traded to non-traded sector
- factors of production move from traded sector to non-tradable and base material sectors
- ✓ As a result: lower output in traded sector
- ✓ Tradable sector is important for economic growth

## The "Dutch" disease: how significant is it?

- ✓ There is no convincing evidence of a causal link between income from export of resources and a decline in industrial production. (**Hutchison, 1994**) explained stagnation in Norway, Netherlands, and Great Britain in 1970–1980 by other reasons.
- ✓ If Russian economists were asked in 2002 what would happen if oil revenues grow threefold, everyone would agree that the Russian manufacturing industry will not survive. Advocates of the “Dutch disease” theory may argue that industrial growth is driven by public procurement; however, from the point of view of the political economy, even this is not a serious argument. As the government manages to redistribute oil revenues between all sectors of the economy it means there is no the “Dutch disease” (**Sonin, Guriev, 2008**).

## The "Dutch" disease: how significant is it?

- ✓ Industry data do not allow to conclude that Russia has the “Dutch disease”: although prices in the services sector grew along with oil prices, a causal relationship between them was not found (**Zamulin, Sosunov, 2007**). It is essential that the main feature of the “Dutch disease” – the stagnation of the manufacturing industry – is not observed: manufacturing industry growth rate is not lower than in the service sector.
- ✓ OECD economists (**Ahrend R., de Rosa D., Tompson W., 2007**) supported these results by a comparative study of the economic dynamics of Russia and Ukraine, which the authors regard as a suitable model for “Russia without oil and gas”. In analyzing the data stagnation of the manufacturing industry was not found.

# Resource curse: institutional aspect

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How can the resource availability have a negative impact on development from an institutional point of view?

- ✓ Conflict because of the access to natural resources (**Olsson, 2006**). Special interest groups spend their resources not on increasing productivity, but on fighting for rent. As an example of degenerate cases - civil wars in Nigeria in Sudan
- ✓ Increasing resource prices is most dangerous when institutions are not well developed (**Gylfason, 1999, 2001**); (**Sonin, 2003**); (**Mehlum, Moene, Torvik, 2006**)
- ✓ The resource availability can spoil the institutions that function in a given economic system (**Ross, 2001, 2008**); (**Wasciarg, 2009**); (**Treisman, 2009**); (**Egorov, Guriev, Sonin, 2009**).
- ✓ Observations show that the «resource curse» affects not all countries, but only countries with underdeveloped political institutions.

# Resource curse: institutional aspect

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- ✓ Macroeconomic policies are endogenous and depend, among other, on the national conditions in which they are implemented.
- ✓ Policy makers maximize rent: they are interested in development and growth, but only to the extent that they can get some co-benefits.
- ✓ The higher resource rent reduce the incentives for institutional development:

*In a country where resource rent has appeared, policy makers may have incentives to dismantle those institutions that force them to work diligently or honestly, because they can ensure their presence in the government not by hard work, but by distribution of rent.*

- ✓ In some countries, resources price increase took place with a dismantling of institutions such as press freedom and free election (Mexico, Venezuela). Various studies show that in countries rich in oil, oil price increase may even contribute to the complete dismantling of democracy (**Ross, 2001**); (**Tabellini et al, 2010**).

## Resource curse: institutional aspect

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- ✓ There is a «conditional curse»: in countries with developed political and economic institutions, oil wealth does not affect growth negatively (there is no impact or there is positive impact). In immature democracies there is a negative impact, moreover, in these countries oil abundance leads to delays in reforms implementation and further destruction of institutions (**Polterovich, Popov, Tonis, 2007**).
  
- ✓ In a condition of the political equilibrium, increasing the «oil bonus» and intensifying the struggle for rent reduce the demand for good institutions (**Sonin, 2005**).

## Resource curse: institutional aspect

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- ✓ The hypothesis that the «resource curse» threatens primarily countries with weak political institutions is also confirmed by the experience of developed countries: conjectural changes do not lead to a deterioration of institutions in such countries.
  
- ✓ Example of how the sudden appearance of an additional source of income made it possible to postpone the long overdue necessary transformations — the «Kosygin reforms». They began in the mid-1960s shortly after the new leadership of the country took power, as a response to the declining living standards. However, at the end of 1960s, new large oil and gas fields were discovered in Western Siberia, and petrodollars poured into the economy. In fact, from this point on, reforms were suspended, and then simply buried.

# Role of the sovereign wealth fund

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## Two main goals

- ✓ ***Macroeconomic goal:*** generation of government savings, holding off a strengthening of the real exchange rate of national currency and smoothing the consequences of the «Dutch disease».
- ✓ ***Institutional goal:*** the reduction of rent forces policy makers to work more efficiently and not postpone reforms through «buying» the presence of bad institutions in the country. In turn, political leadership in well developed institutions can create the right incentives for bureaucrats.

**In fact, with the help of sovereign wealth funds, in the long run the negative impact of a resource can be minimized by securing at the institutional level a prohibition on using this resource in unlimited amounts.**

# Role of the sovereign wealth fund

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## Examples

- ✓ The most successful example is Norway. Generation of government savings, holding off a strengthening of the real exchange rate of national currency and smoothing the effects of the «Dutch disease». In Norway, The Government Pension Fund Global for future generations already accounts for more than 200% of GDP and the using of any part of these funds is prohibited by law (except for income from the placement of this fund - approximately 4-6% of GDP, which is not dependent on world market conditions).
- ✓ It should be noted that 100% of GDP, with proper use, could be enough for any dictator to completely dismantle democratic institutions in the country within one decade.

# Role of the sovereign wealth fund

## Examples

| Country (fund)   | Share in GDP at exchange rate |
|--|-------------------------------|
| Kuwait (Kuwait Investment Authority)   | 492%                          |
| Brunei (Brunei Investment Authority)   | 471%                          |
| Norway (Government Pension Fund Global)  | 267%                          |
| Libya (Libyan Investment Authority)  | 211%                          |
| Qatar (Qatar Investment Authority)   | 192%                          |
| UAE (Abu Dhabi Investment Authority)   | 181%                          |
| Azerbaijan (State Oil Fund)  | 82%                           |
| Saudi Arabia (SAMA Foreign Holdings)   | 75%                           |
| Kazakhstan (Sovereign Wealth Fund «Samruk-Kazyna» + National Fund of the Republic of Kazakhstan) | 74%                           |
| Oman (State General Reserve Fund)  | 24%                           |
| Iran (National Development Fund of Iran)   | 21%                           |
| Australia (Australia Future Fund)  | 8%                            |
| Russia (Russian National Wealth Fund + Russian Direct Investment Fund (RDIF))                    | 6%                            |
| Canada (Alberta's Heritage)  | 1%                            |

Source: Sovereign Wealth Funds Institute <http://www.swfinstitute.org/fund-rankings/>; World Economic Outlook Database <https://www.imf.org/external/pubs/ft/weo/2018/01/weodata/index.aspx>

## The main conclusion

*The maximum budget discipline and the attempt to force policy makers to accept the rule that this budget discipline will be fixed as clearly as possible* is a probable mechanism for creating the right incentives for the rest sectors of the economy (primarily processing sector), because in this case, perhaps, policy makers and bureaucracies do not will have the rent for «buying» the presence of bad institutions.

Thank you for your  
attention!