Managing resource revenues

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Introduction

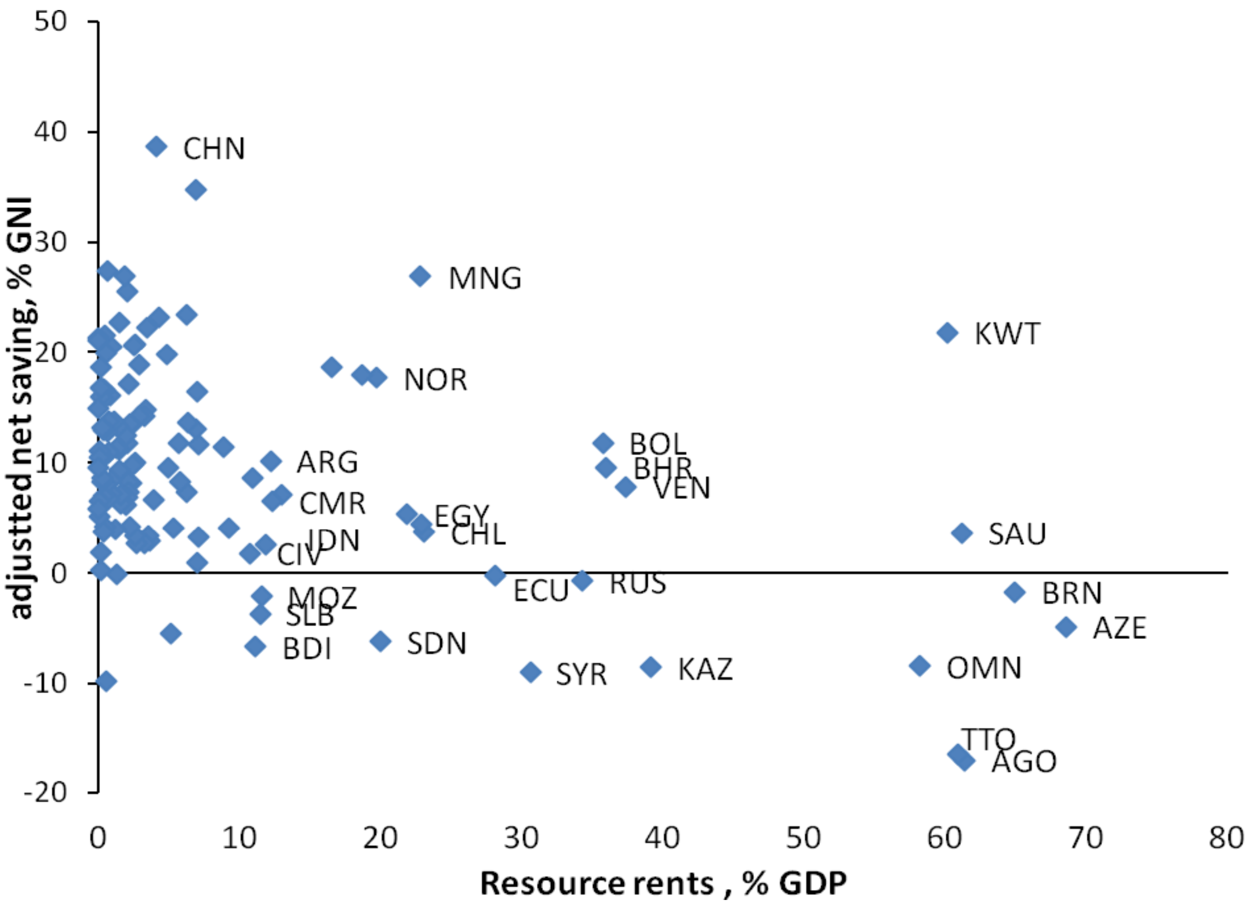
- Objective: Transform subsoil assets into surface assets that yield sustainable flow of income and employment

- Successes and failures
  - case studies illustrate a wide variety of causes

- Two repeated mistakes
  - Boom and bust
    - Inefficient spending
    - Long ‘stops’ following the bust
  - Save too little
    - Failure to develop surface assets (public or private)
    - Nigeria: real savings -30% GDP

- Broad-brush overview of policy to avoid these problems
  - More detail to follow in later presentations
  - Will talk in terms of aggregates – but micro details crucial

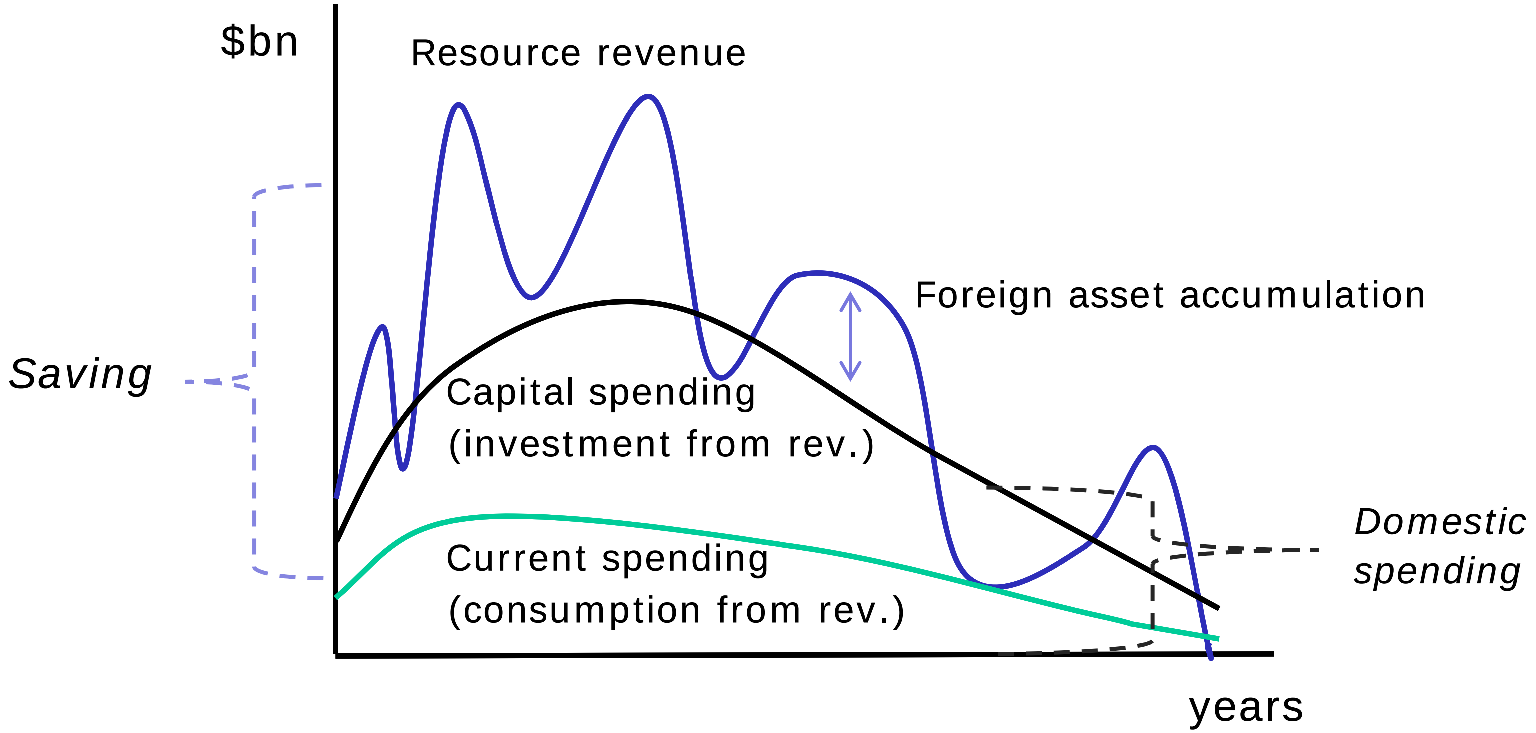
Real savings rates



Adjusted net savings, excluding particulate emission damage (% of GNI)

Options for resource revenue:

Balance between: Current spending, capital spending, foreign assets



Two key features of 'optimal' revenue management:

- Avoid boom-bust by smooth path of domestic spending – decoupled from resource revenue
- Saving and domestic investment a high proportion of revenue

I: Consumption/ saving

Trade-off between:

- High savings rate:
  - Inter-generational equity & exhaustability of the resource
    - Save higher share of revenue the shorter the duration
  - Sustained economic growth brings benefits many times larger than resource revenues.

- Consumption:
  - Ultimate benefit is higher income/ consumption of citizens
  - High levels of poverty → need for current consumption.

I: Saving / consumption

Resolving the trade-off:

- Savings share high (> 50% of resource revenue) and rising through time ↔ cons. share falling
  - Economic growth is increasing non-resource income
  - Duration of remaining revenue falling

Micro-detail:

- Effectiveness of current spending:
  - Wasteful subsidies?
  - Tax reductions, conditional cash transfers?
  - Takes time to implement good spending

II: Domestic investment

Savings can go to domestic investment or foreign assets:

- **Domestic investment**:
  - Developing economies are capital scarce, infrastructure scarce: use resource revenues to fill this gap
  - Discovery itself likely to raise return to domestic investment – booming sector/ new infrastructure demands
  - Private investment is key to growth:

    Public investment may encourage private investment:
    - Infrastructure
    - Lending/ interest rates

II: Domestic investment

- **Can the economy absorb extra spending and investment?**
  - Micro detail:
    - Supply of projects.
    - Process for appraisal, selection & implementation
  - Risk of boom-bust: bottlenecks, inflation, and Dutch disease
    - Avoid too rapid increase in domestic spending
    - Openness to trade and imported capital (and projects?)
    - Anticipate bottlenecks – investing-in-investing

III: Foreign asset accumulation (debt reduction)

- Set domestic spending (current and capital) to what the economy can absorb efficiently, avoiding boom and bust
- Foreign assets play role of decoupling domestic spending from revenue flow.

- Can think of foreign assets as playing 3 roles:

- **Stabilization**:
  - Price volatility one of the major factors driving poor performance.
  - Handle price fluctuations by stabilization fund.

III: Foreign asset accumulation (debt reduction)

- **‘Parking’**:
  - Absorption problems → do not build up domestic spending too fast.
  - ‘Park’ revenues off-shore until efficient spending possible
  - Also builds up stock of foreign assets needed for stabilization.

- **Future generations fund:**
  - Need to pass on assets -- argued for high savings & domestic investment
  - Country specific – is there capital scarcity/ high return projects?
    - Norway – off-shore pensions funds
    - Developing country – domestic investment preferred

Concluding comments

- Resource revenues are a means to an end
  - Want to end up ***not*** dependent on resources

- Downside risks
  - Resources destabilize economy
  - Resources lead to unsustainable spending commitments
  - Resources damage other sectors
  - Resources corrupt institutions

- Revenue management needs to strike a balance
  - Legitimate demands for current consumption.
    - but have to leave space for saving.
  - Scale-up saving and investment.
    - but in good projects and through effective processes
  - Avoid boom and bust.
    - management of foreign assets to stabilize domestic spending