Economic Diversification in Resource Rich Countries

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Overall, Developing Countries Have Diversified Remarkably

- 80% exports were primary – now 80% industrial. Some countries are major industrial powers
- Some have moved downstream
  - Latin America 1975-84: basic metals exports doubled; fabricated products grew 8 times
- Some have diversified within resource-based sectors (fresh produce, fish, tourism)
- Africa heavily dependent primary sectors
  - Almost all industrial exports are processed primary

Mineral Exporters Often Less Diversified, Especially Oil

- About 35 countries heavily dependent on oil and gas (includes one third of SSA area and population), another 12 on hard minerals
- High Dependence:
  - oil: often 60%+ exports, 50% + fiscal revenue
  - and true dependence is even higher because "non-oil" taxes depend on oil-fuelled spending
- Direct linkages often modest relative to fiscal linkage

Many seek to diversify.

Why?

Policies?

Examples?

Why Diversify Away From Advantage?

- Diversified economies do better in the long run: those locked in to resource exports do worse…….
- Learning by doing, and greater "self discovery"?
  - A premium on manufacturing? On "connected" products?
  - Or, just move upstream or downstream in resource chain?
- Fear of resource exhaustion?
- Fear population growth will reduce natural rent/head?
- Fear potential substitution risk (nuclear +batteries for oil?)
- Need to generate jobs?
- Economic diversification reduces macro instability?
- See higher return on domestic spending?
  - Portfolio diversification alone has risks?

Every country has different needs and potentials

But motivation should be clear because it will shape policy

Diversification and “Resource Curse” Two Sides of One (Policy) Coin

Countries more likely to avoid the ‘resource curse” are also better placed to diversify economies.

- Limiting “Boom-Bust Cycles”
- Building human capital
- Building institutional (governance) capital

Plus

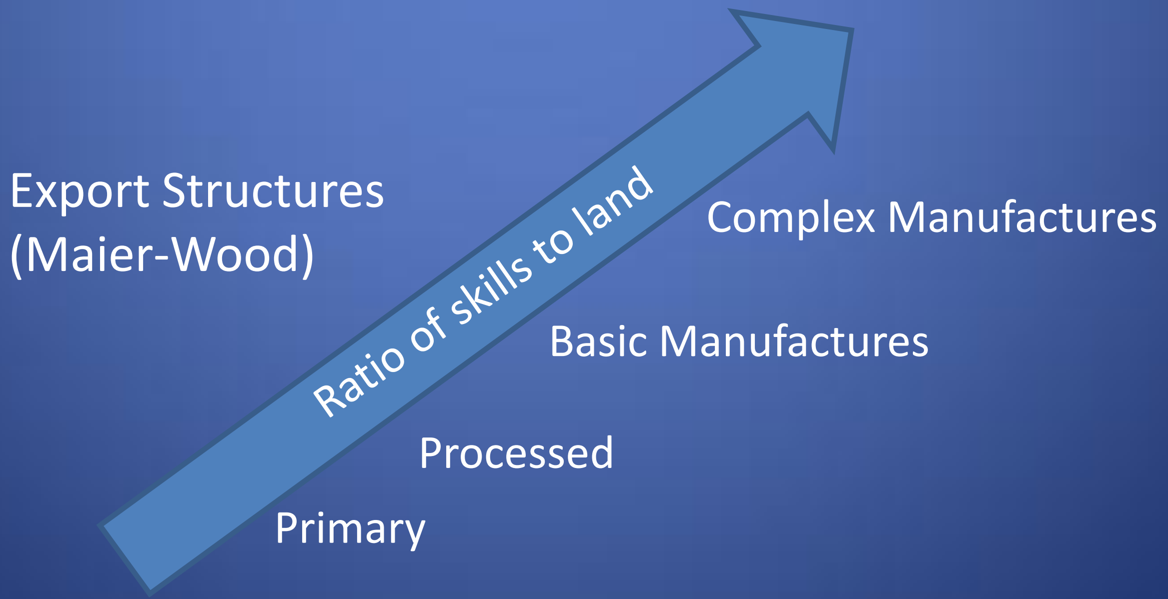
- The issue of sectoral policy
- Spatial policy: SDIs and resource corridors

1 Limiting Boom-Bust Cycles

- Resource prices highly volatile and unpredictable
  - Especially oil prices; cannot predict turning points
- Few countries have sustained counter-cyclical policies. Volatility is associated with slow growth
  - Fiscal policy is paramount
  - Exchange rate policy: dilemma for real ex rate
  - Monetary policy – selective (real estate bubbles)
  - Trade policy – cannot shut off imports
- Volatility also discourages investment in non-resource traodeds -> premature specialization -> less diversification -> more volatility

2 Building Human Capital

- Larger stock of human capital: more positive is resource abundance for growth.
- Low human capital also limits diversification
  - High land/head, low skills/head: primary exporter
  - Low land/head, high skills/head: industrial exporter



3 Building Institutional Capital

- Natural resources only have negative impact when institutions are poor
- Especially for non-resource countries institutional measures track income and productivity
  - Most resource exporters lag badly. Harder to diversify

4 Sectoral Policies and Public Spending

- "Old-Style" industrial policy (CAD) discredited. But are market forces enough? More interest in new-style (CAF) policy aimed at compensating for market and coordination failures .
- Special issues for resource exporters:
  - Long-term national goals may not shape shorter-term investments
  - To diversify, need to lower costs in non-resource traded and spur productivity, against the pull of market forces. Special measures can help
  - Have greater possibilities of financing programs for these sectors
  - Part of decision on how to spend natural rent: pro-diversification or against it?

Sectoral Policies (continued)

- But resource countries face particular risks:
- “Lock-in” to the interests of elites seeking rent through incentives
- Excessive import-substitution bias (successes are export oriented)
- Diversion of policy effort from the basics
  - It is easier to introduce a new program than correct deep problems
- Holding on to failing policies because there is less fiscal pressures to reform them.
- Poorly conceived or implemented programs worse than nothing because their demand effects pull resources away from non-resource traded sectors.

Spatial Policies

- Resource sector can support local externalities: multi-use infrastructure, input demand, other demands, etc.
  - Multi-layer spatial linkage
  - Maximize backwards linkage: suppliers and others
- Resource development corridors and SDIs:
- Maputo, Nacala, Madagascar Growth Poles

The Shopping Center model

with mining as the anchor tenant

Some Country Examples

- Malaysia Indonesia Chile (M,I,C) have grown well from strong mineral resource bases. All have diversified their sectors and exports: primary towards manufactures (M, I) or widening primary-based (C). Common features:
  - Prudent macroeconomic management, including devaluation where needed for competitiveness
  - Relatively open trade and open investment policies
  - Efforts at building human capital and a good business climate (M,C)
  - Particular efforts to bring down costs (including labor) that affect exports (M,I) and to work with private sector to spur new export industries (M,C)
- Dubai distinctive with some lessons for building a “new” economy. Objective: critical mass, agglomeration externalities
  - Efficient bureaucracy, strong IT, minimal taxation, tariffs
  - Extremely open to investment, labor, skills
  - Stable exchange rate; low-cost business platform
  - **Boom-bust cycle – very costly.**
- Algeria, Little diversification (despite efforts), stagnant progression up sophistication chain, few new products,
  - Poor business climate; protected market and competition for oil rents dulls private incentives to develop new products and markets
  - In Middle East, industrial policies favor well-entrenched groups not those that benefit from outward-oriented policies.

Factors Encouraging Success

- Long-term goals: economic development and social stability
- Exports, entry, central to development strategy
- Strong and engaged technocracy
- Constituencies for macroeconomic stability outside the resource sector.
- Opportunities to diversify
  - Botswana shows the difficulties for some countries. Good macro-management, strong bureaucracy, business climate. But severe ecological, locational and scale constraints to diversification
    - Can Botswana diamond processing compete with India?

Conclusion

- A strong, concentrated resource base makes economic diversification more difficult. But it also provides opportunities, including funding for investments in infrastructure, human capital, institutions. Many countries do not take them.
- Most countries have options if they want to diversify. The question is how strongly they are prepared to push and whether they can do so against political pressure to use rents in other ways.

Get the basics right; macro, skills, institutions

Successful countries have used sectoral and spatial policies and avoided their dangers.

END