Managing Resource Revenues to Promote Export Diversification in the MENA region: Bringing Back a Developmental Approach

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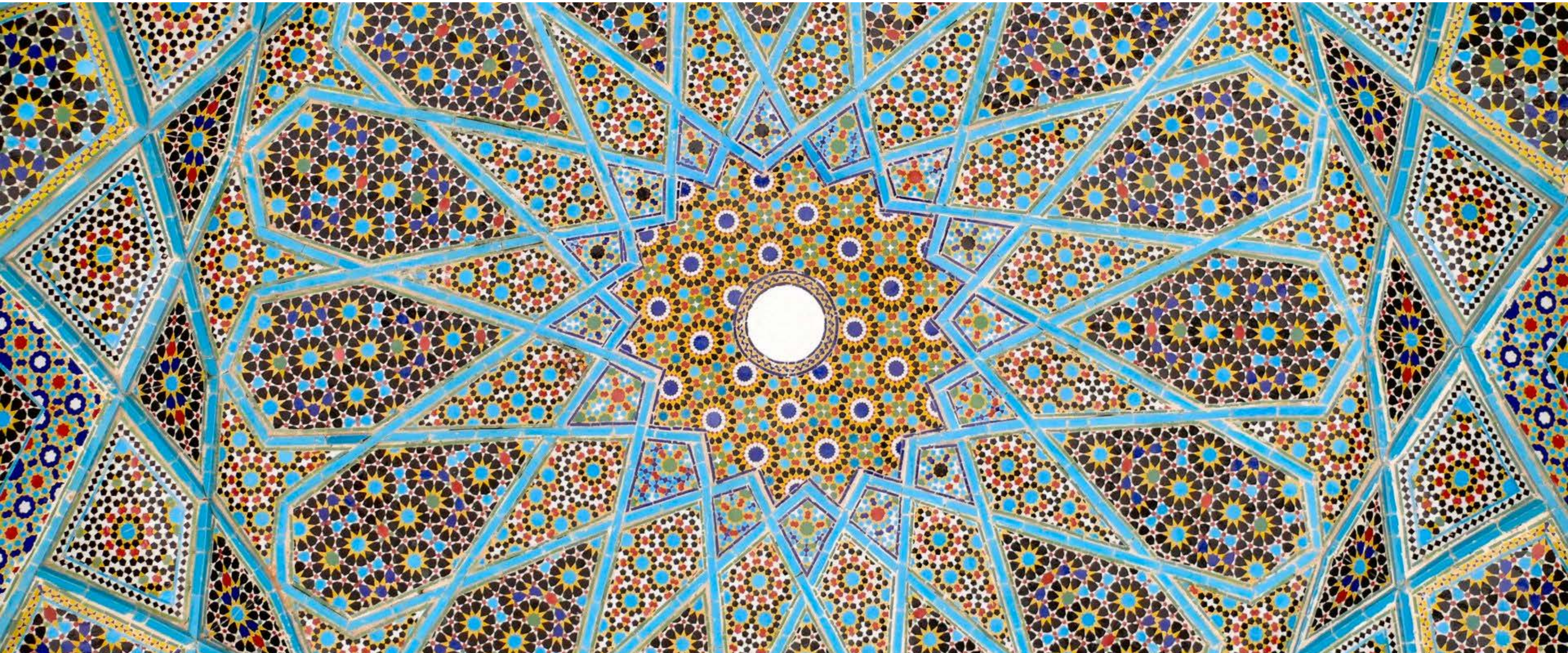


Agenda

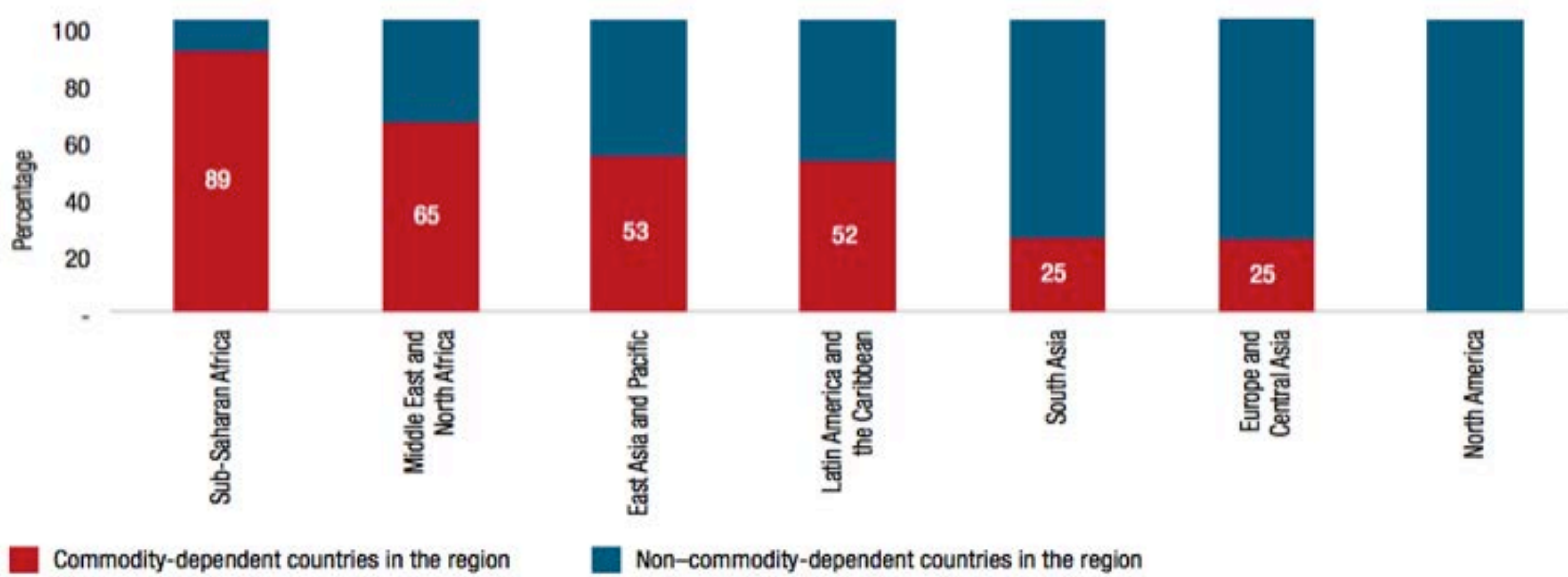
1. Overview of extractive dependence & diversification in the MENA region
2. Options for managing resource revenues and their implications
3. Resource revenue management in MENA: Consumption & financial diversification at the expense of structural transformation.
4. A different model of resource revenue management to stimulate diversification in MENA countries

Extractive dependence and diversification in MENA

The MENA region features very high levels of resource dependence compared to the rest of the world.

- A staggering 34% of all energy dependent countries in the world are located in the MENA region
- 2/3 of the MENA countries are commodity dependent, which is the 2nd highest rate after Sub-Saharan Africa

Figure 1. Distribution of commodity dependent countries within each region (2013-2017)

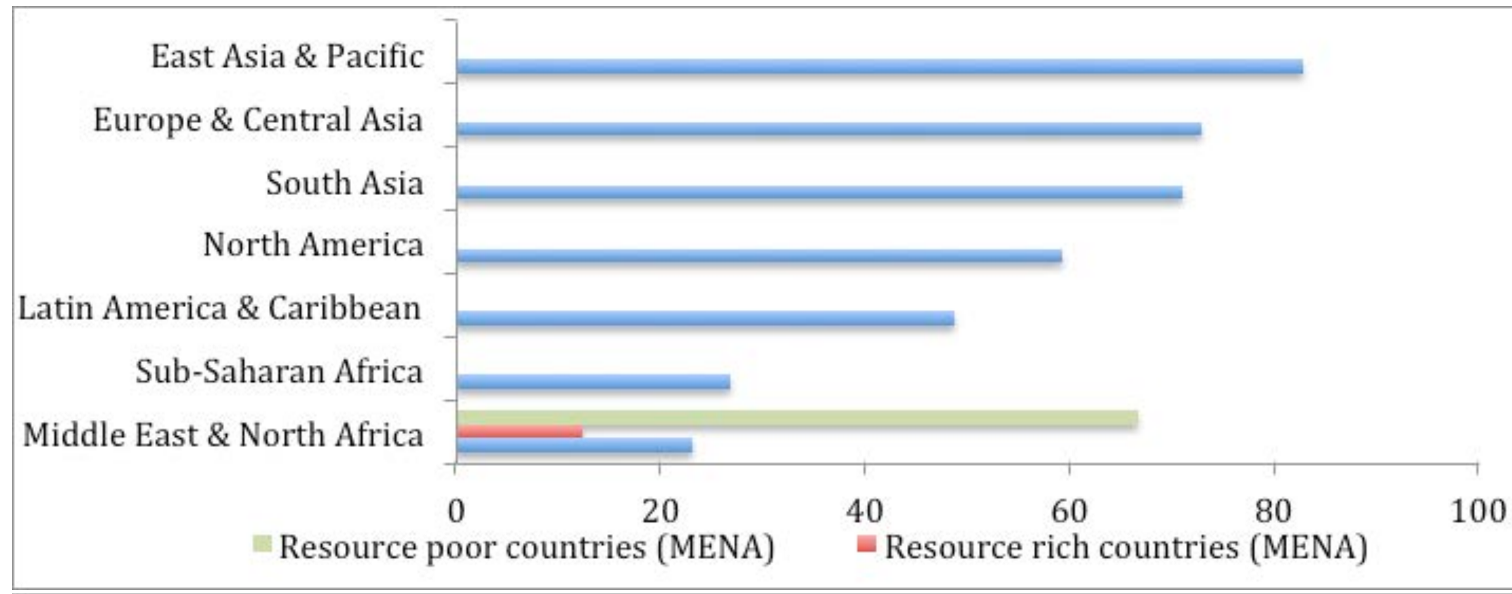


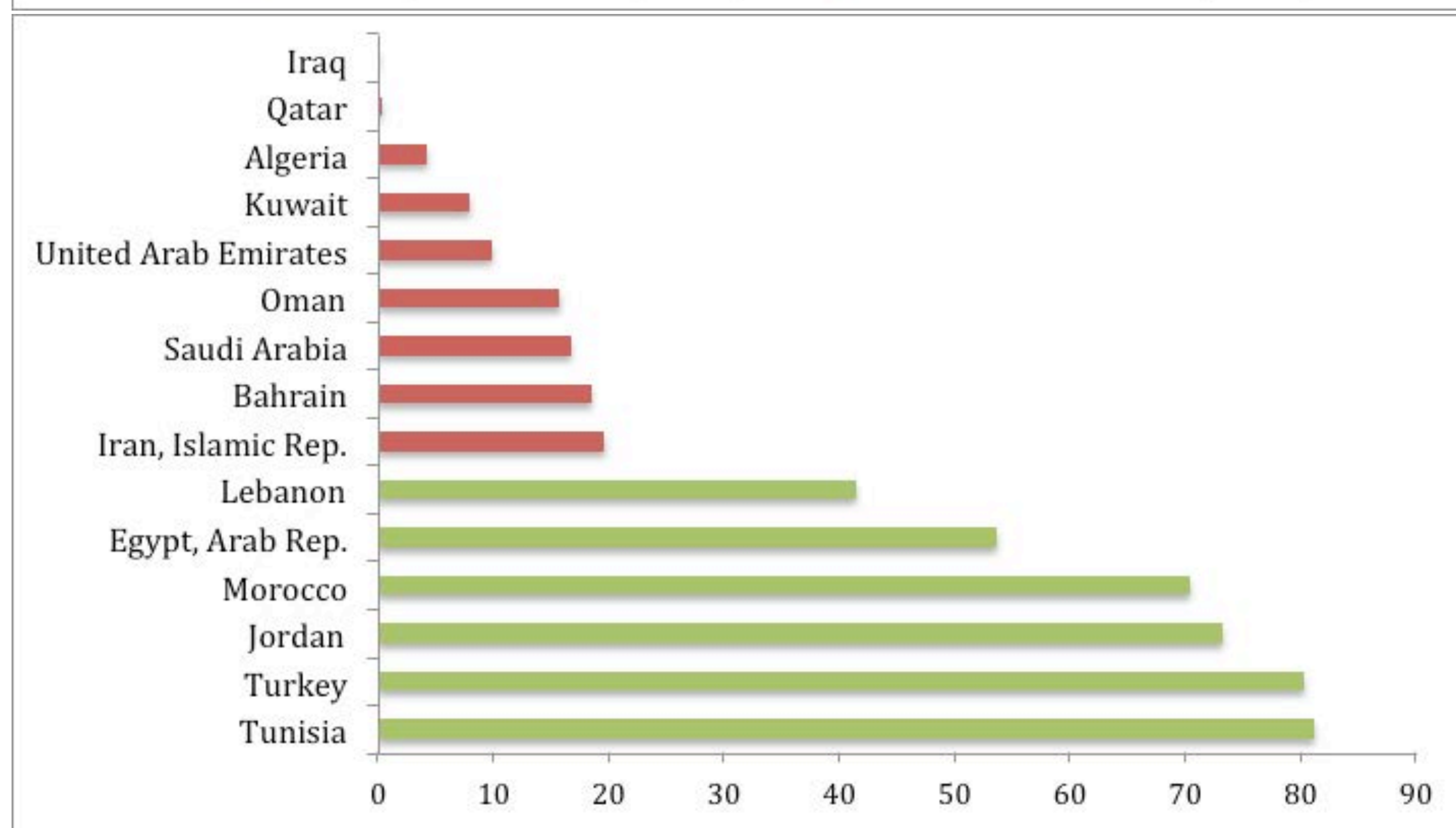
(Source: UNCTAD, 2019)

Extractive dependence and diversification in MENA

The high degrees of export concentration in MENA are mirrored by small degrees of industrial development.

- MENA's shares of manufactured exports in total exports are lower than any other region in the world
- This is due to very low figures displayed by the resource rich MENA countries (around 10.4%, compared to 66,7% for resource poor countries such as Egypt, Morocco, Lebanon, Jordan, Turkey).

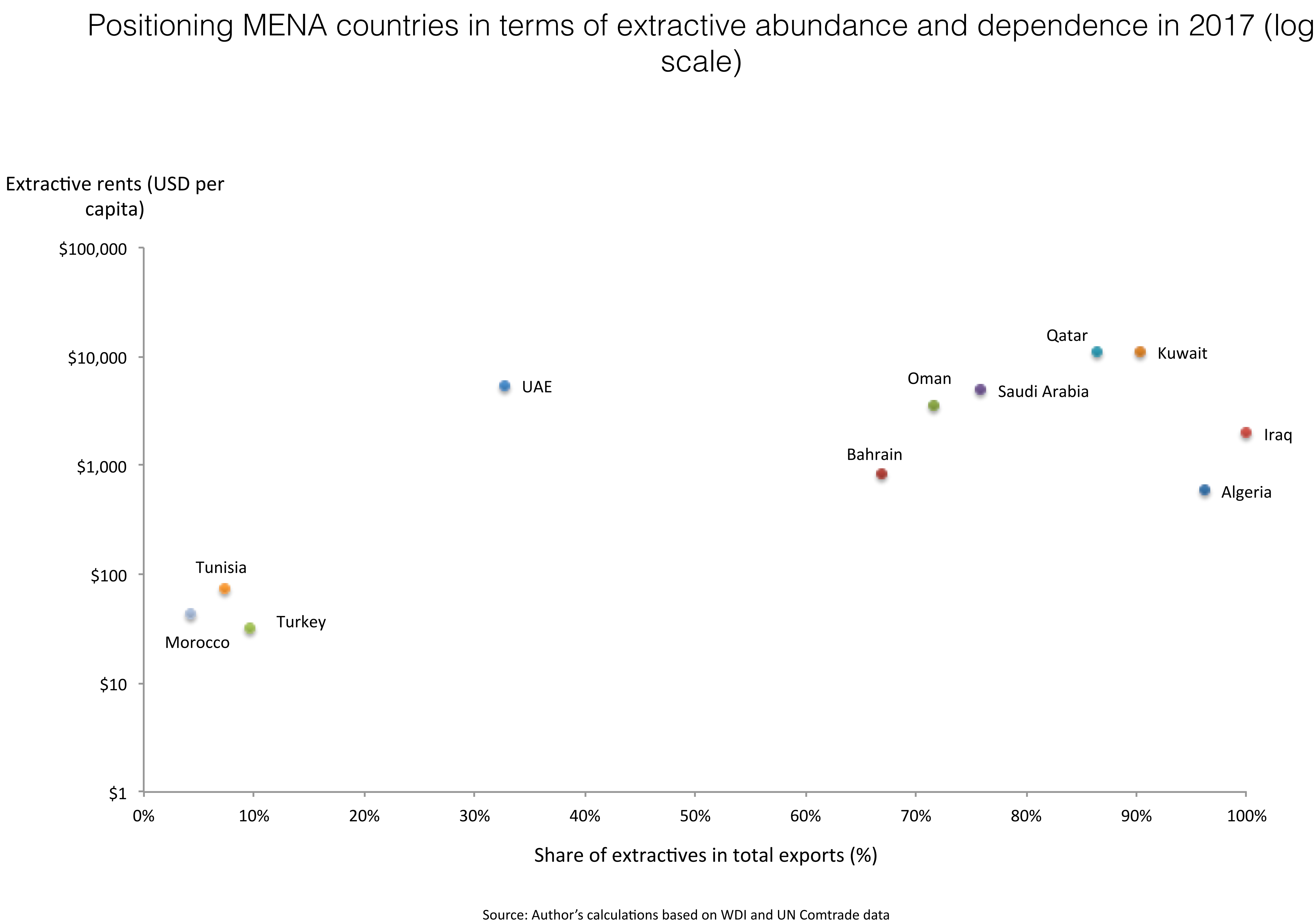




Source: World Development Indicators (2019).

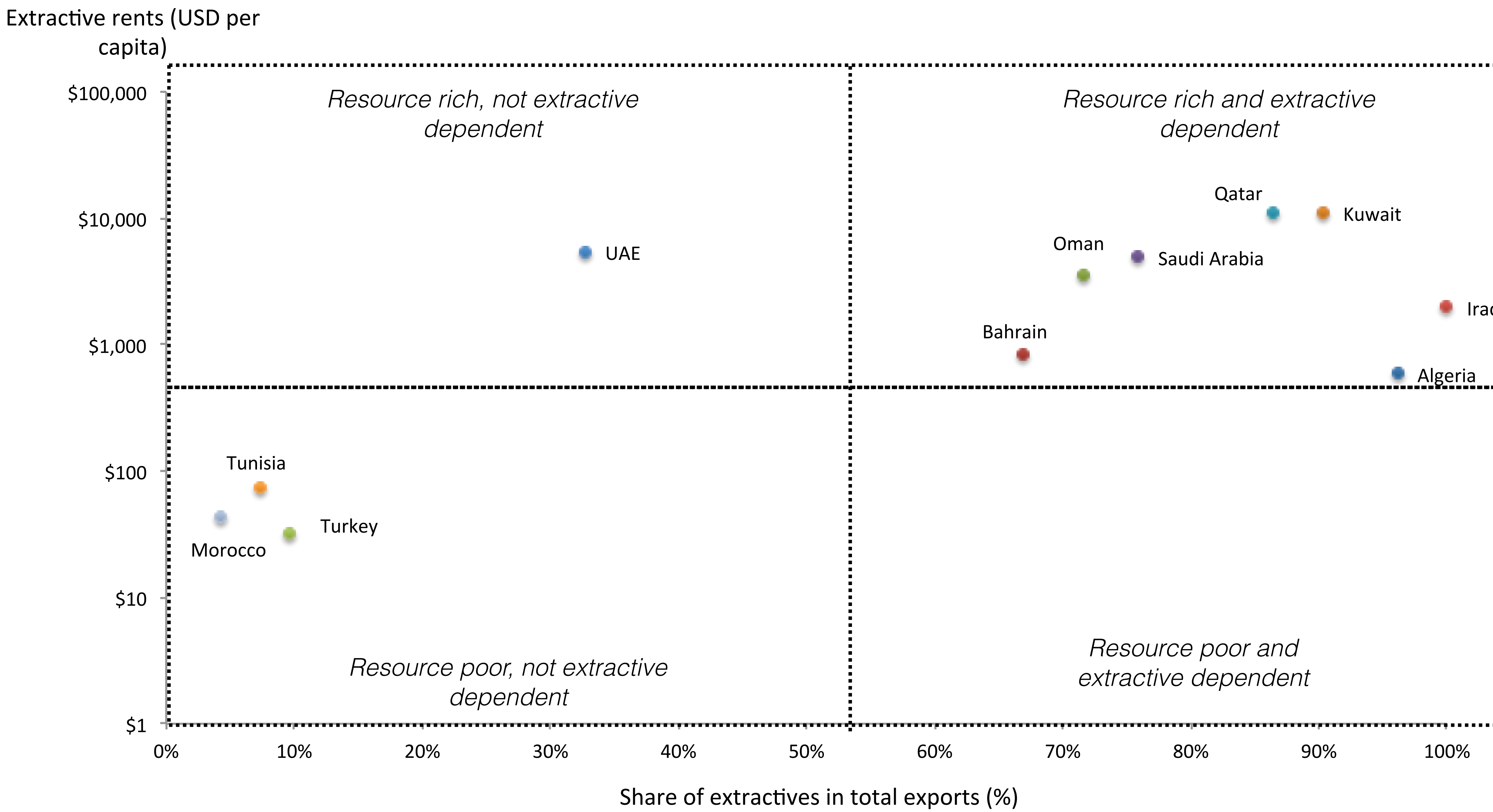
Note: For Qatar, Iraq and Bahrain, the data is for the year 2016 rather than 2017 due to data availability issues.

Extractive dependence and diversification in MENA



Extractive dependence and diversification in MENA

Positioning MENA countries in terms of extractive abundance and dependence in 2017 (log scale)



Source: Author's calculations based on WDI and UN Comtrade data

Extractive dependence and diversification in MENA

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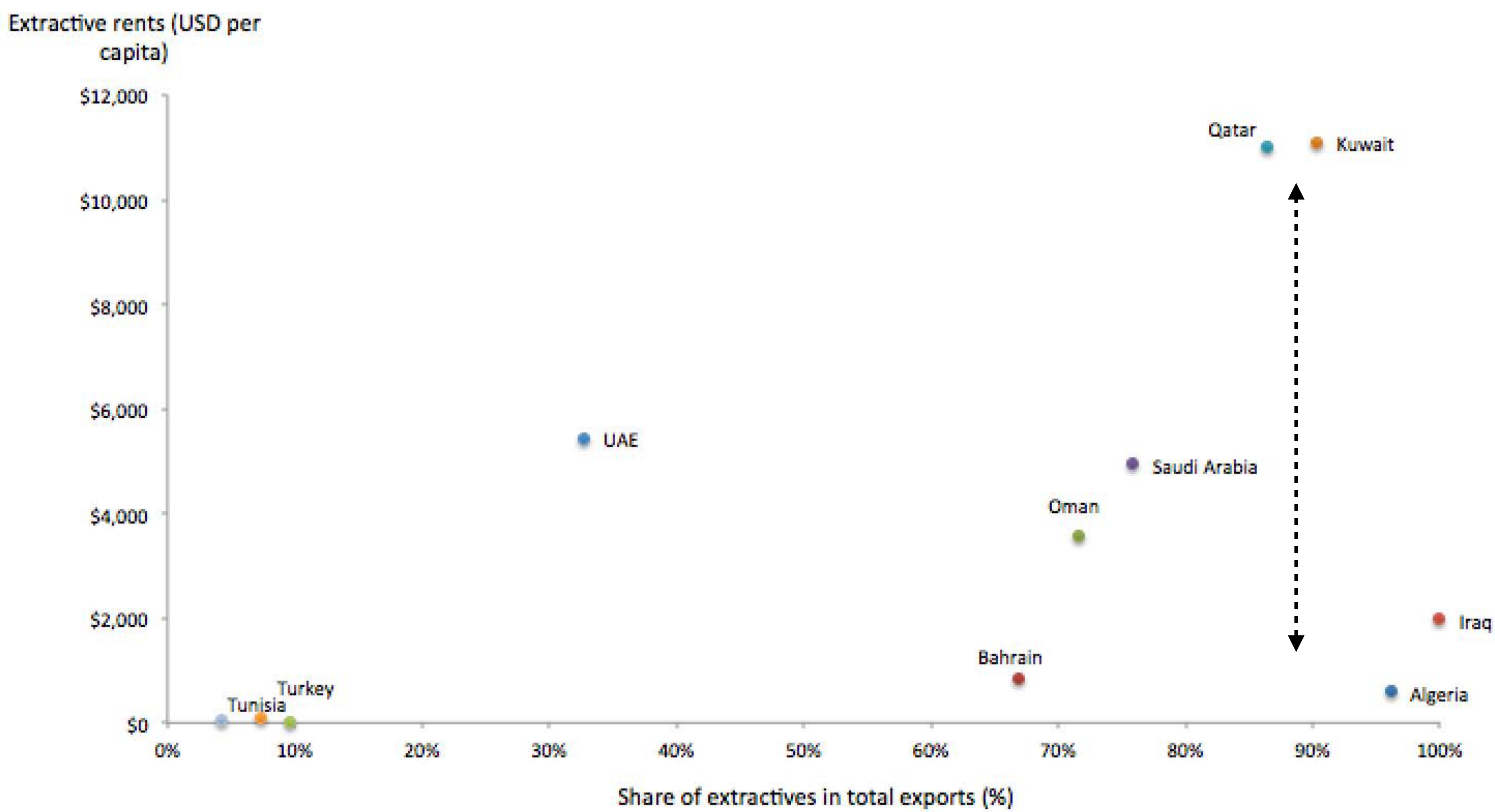

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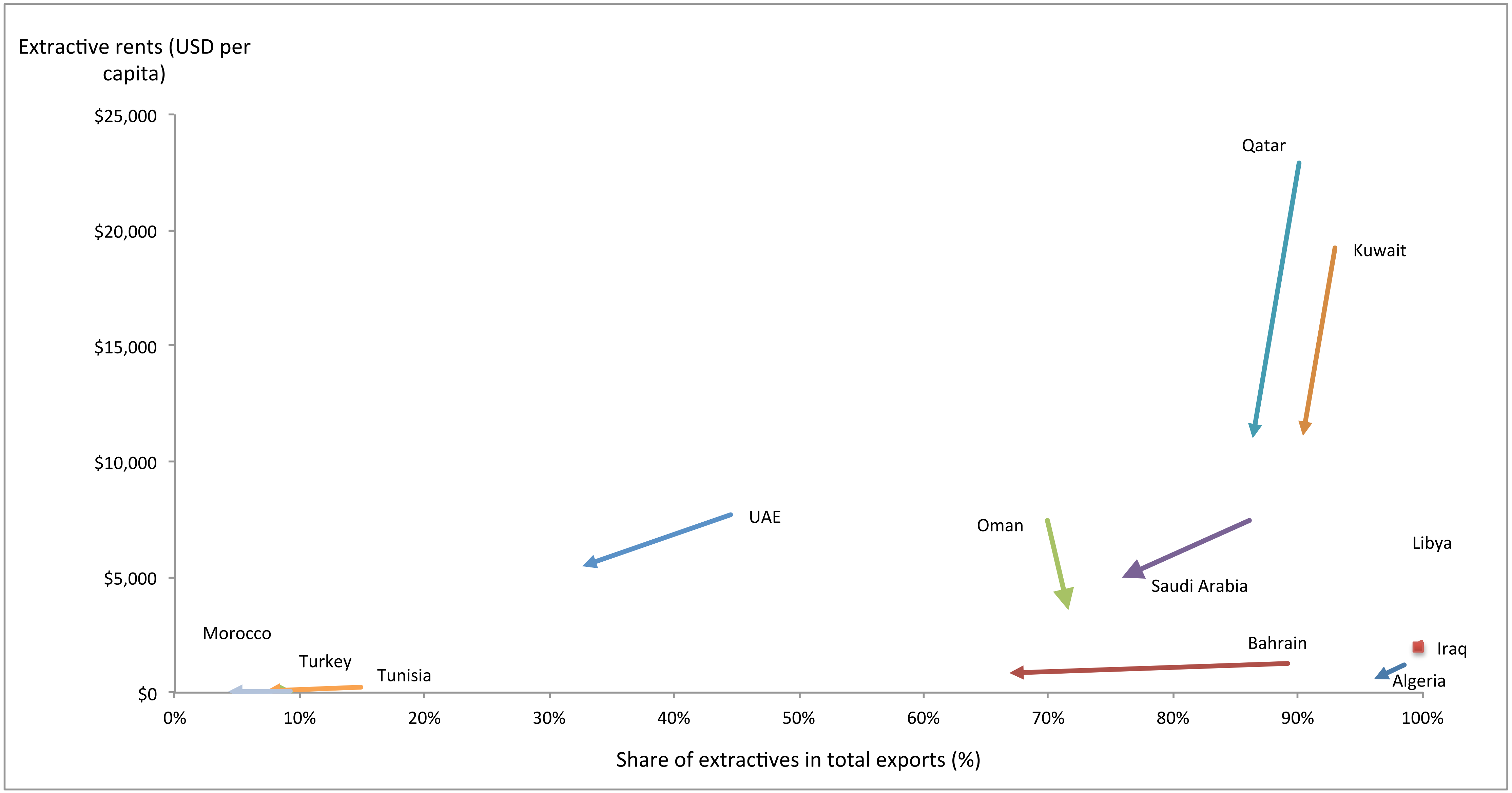
Extractive dependence and diversification in MENA

Mapping movements in terms of extractive abundance and dependence in the MENA region between 2010 and 2017



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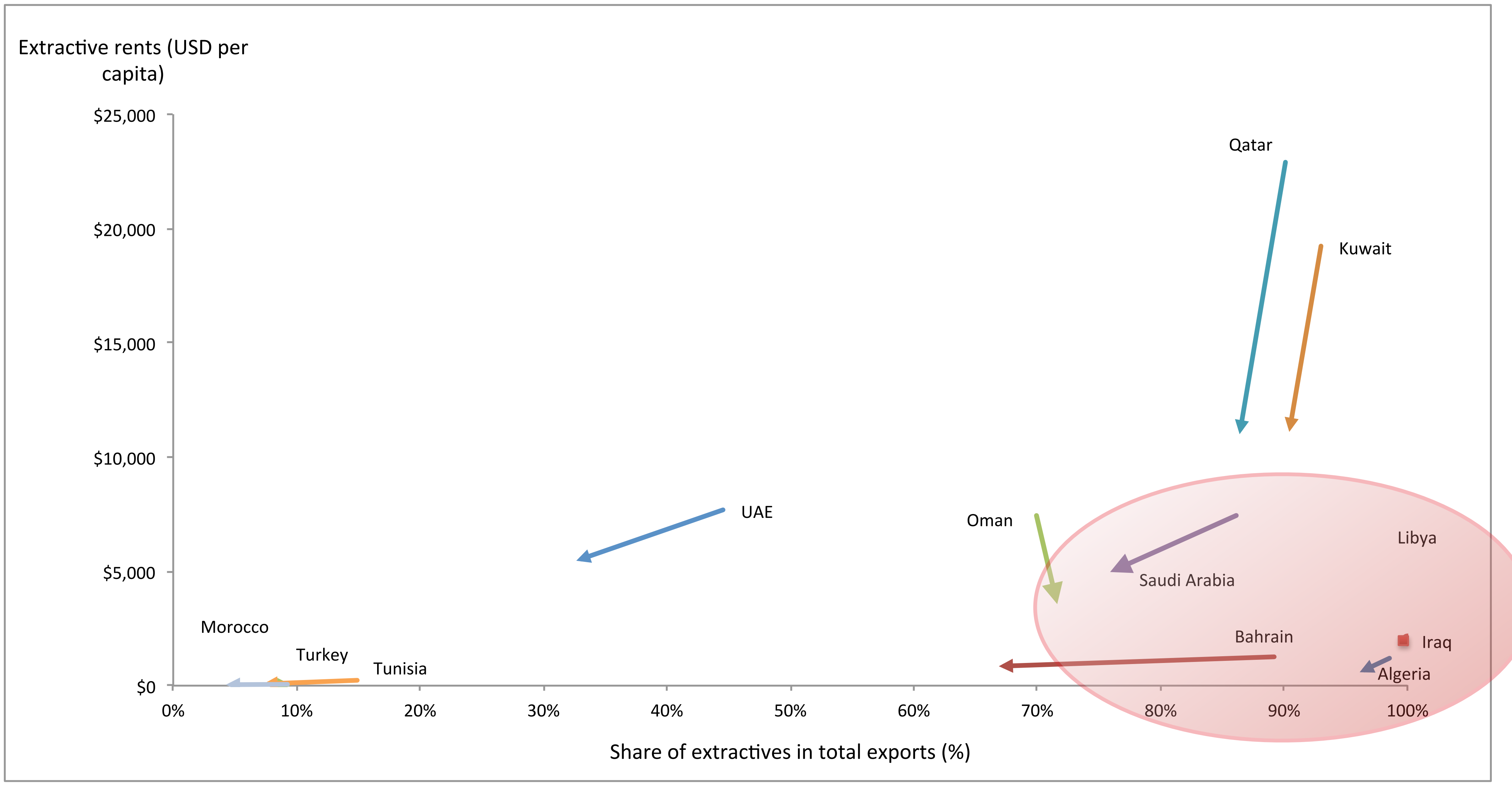

Area that needs to be escaped as urgently as possible

- Bahrain and UAE as the best performers in terms of diversification over the past decade
- Algeria, Iraq, Saudi Arabia are in particularly vulnerable positions. They are not diversifying fast enough.
- Very resource rich countries per capita (Qatar, Kuwait) are also rapidly going towards the red zone

Source: Author's calculations based on WDI and UN Comtrade data

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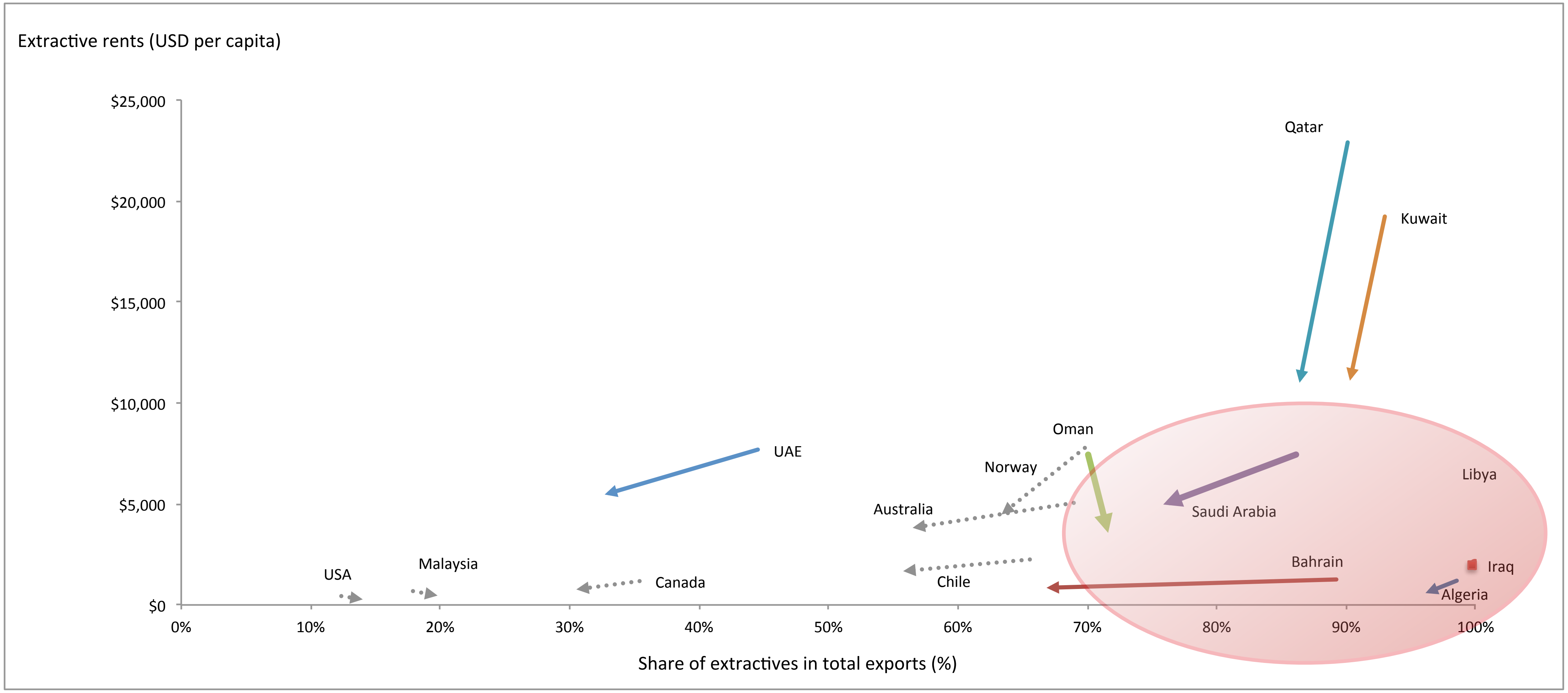

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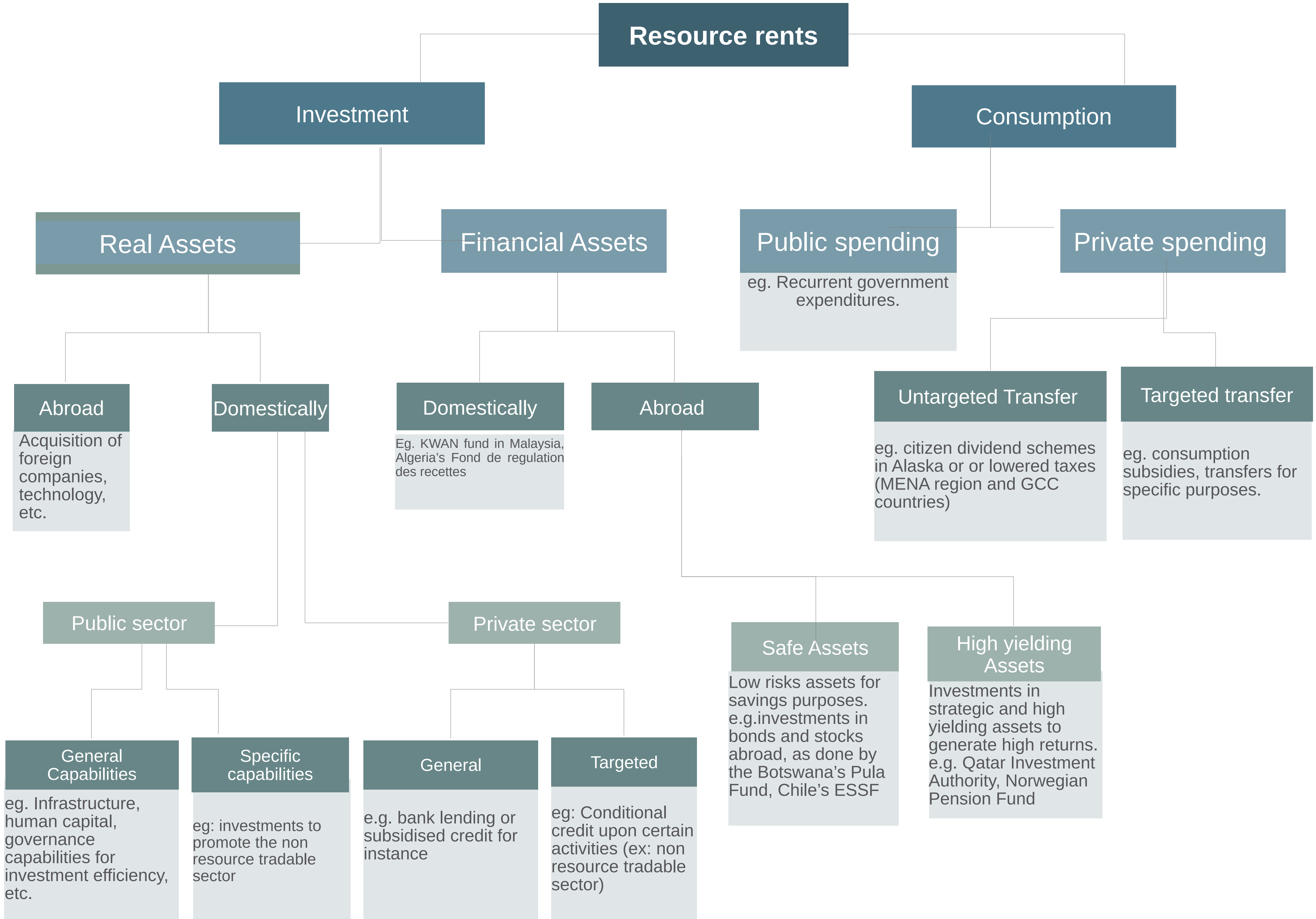
How to manage resource revenues to promote diversification?

The academic literature remains divided on several issues pertaining to how resource revenues should be managed. Several debates exist on whether resource revenue should be:

- Invested domestically or abroad *(see Bauer, 2015; Gelb et al. 2014a; Van der Ploeg and Venables, 2018; Witter and Jakobsen, 2018).*
- Consumed or invested? *(See Bauer et al, 2012; Cherif and Hasanov, 2014; Hartwick, 1978).*
- Invested through a sovereign wealth fund, the general budget, or reserves in the central bank? *(see Gelb et al. 2014b; Mohaddes and Raissi, 2017; Van der Ploeg and Venables, 2018).*
- Earmarked or not? *(see OECD, 2016).*

The next slide maps out several layers of decisions for the government to allocate resource revenues.

Different options for managing resource revenues



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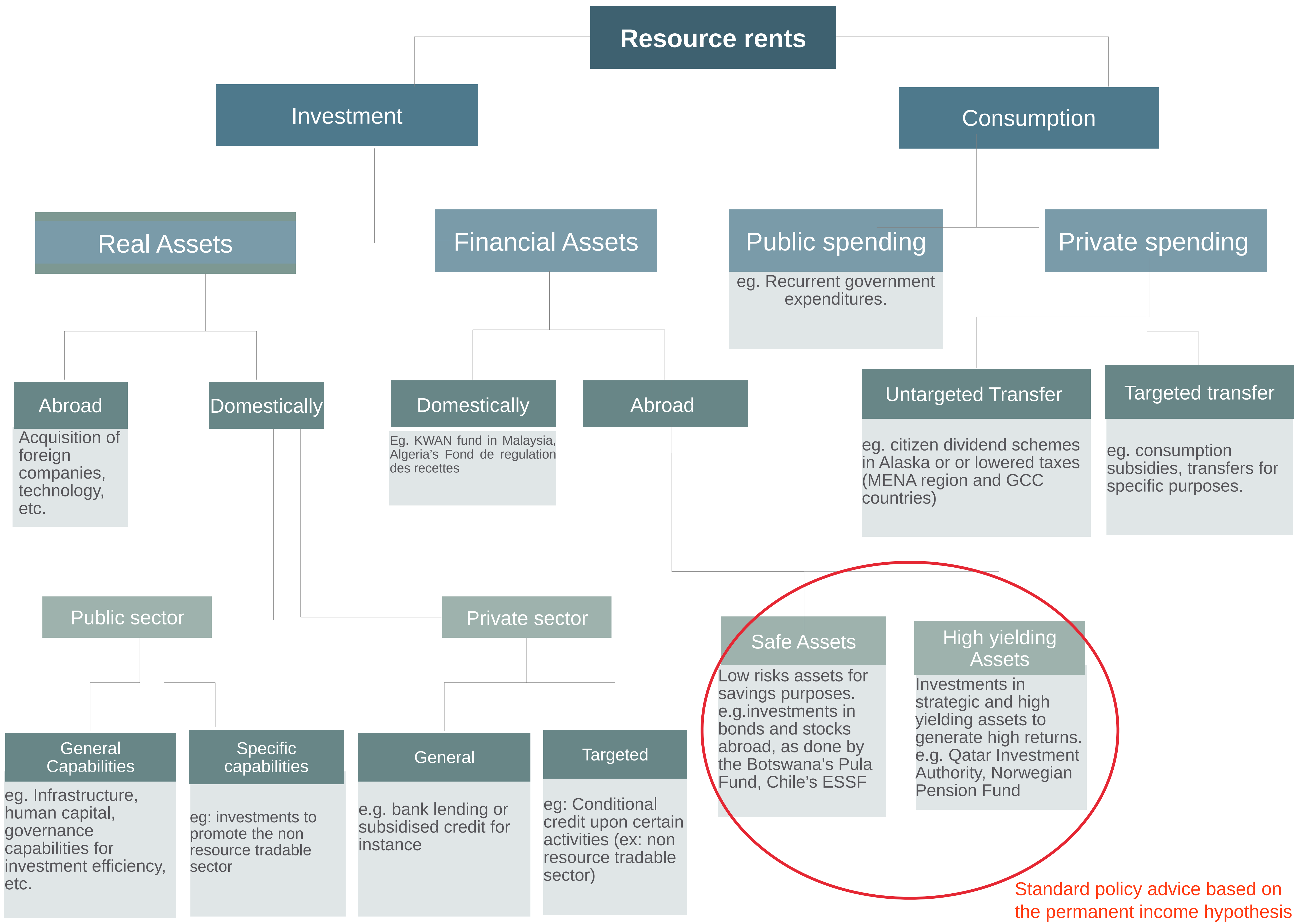

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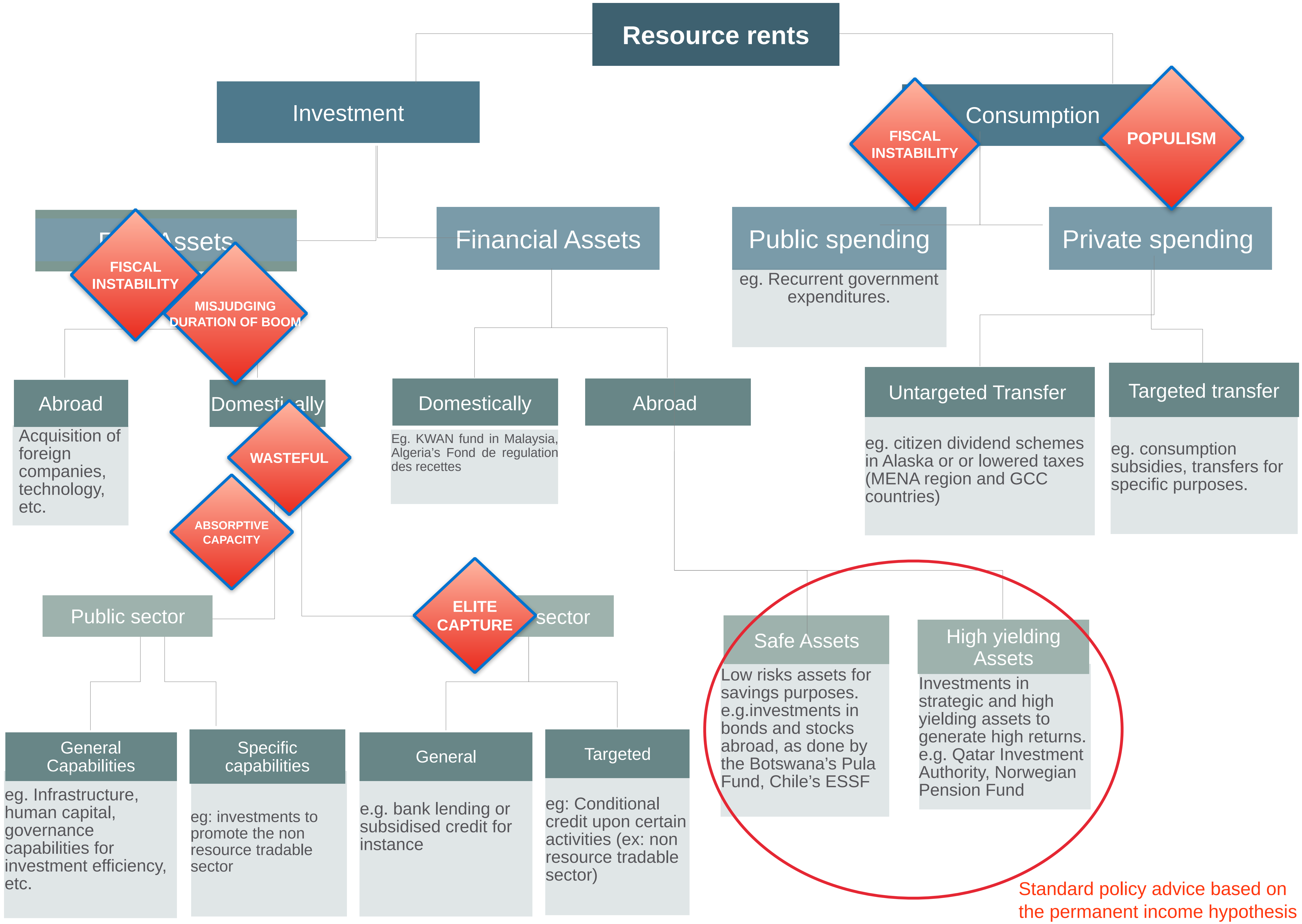

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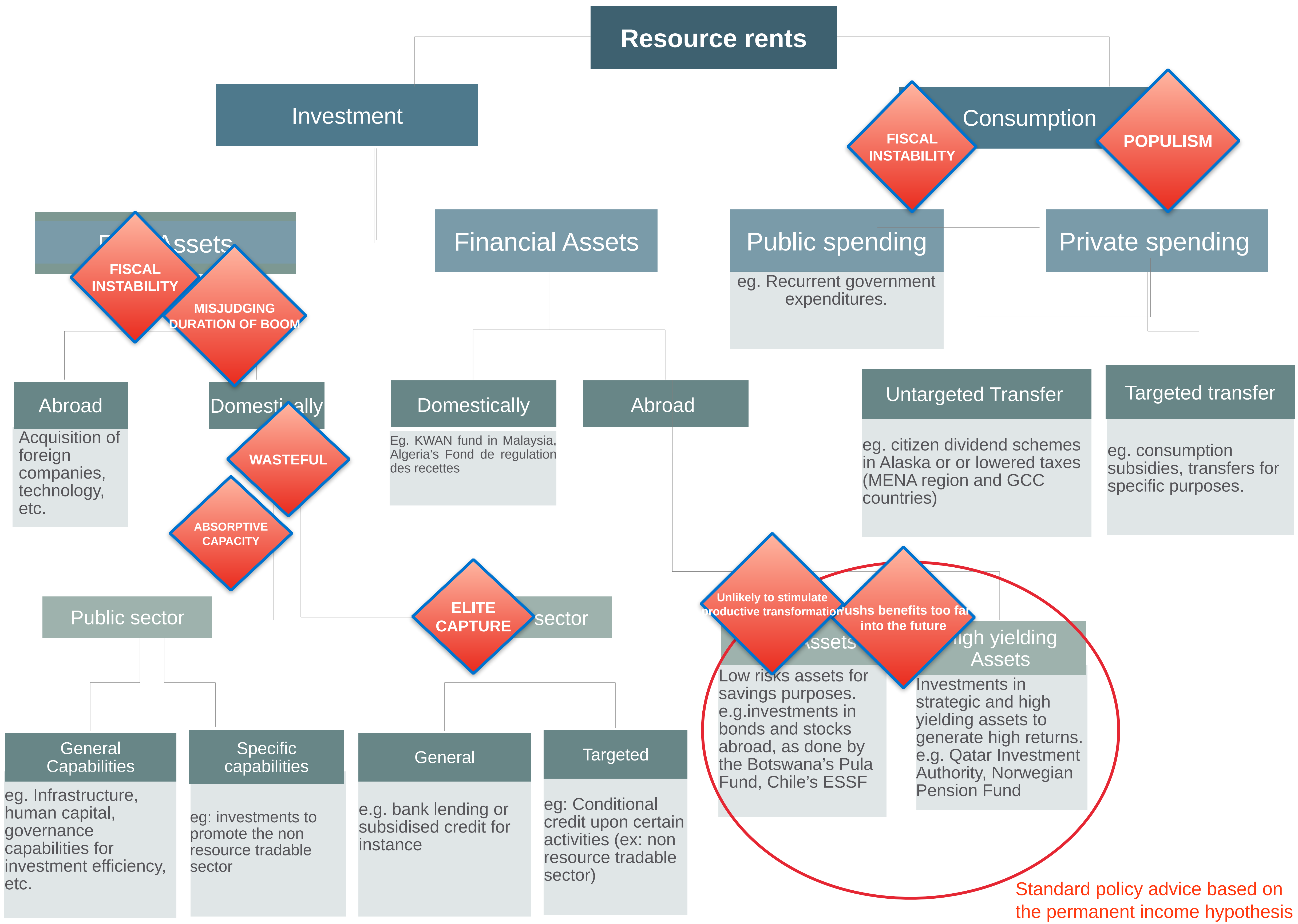

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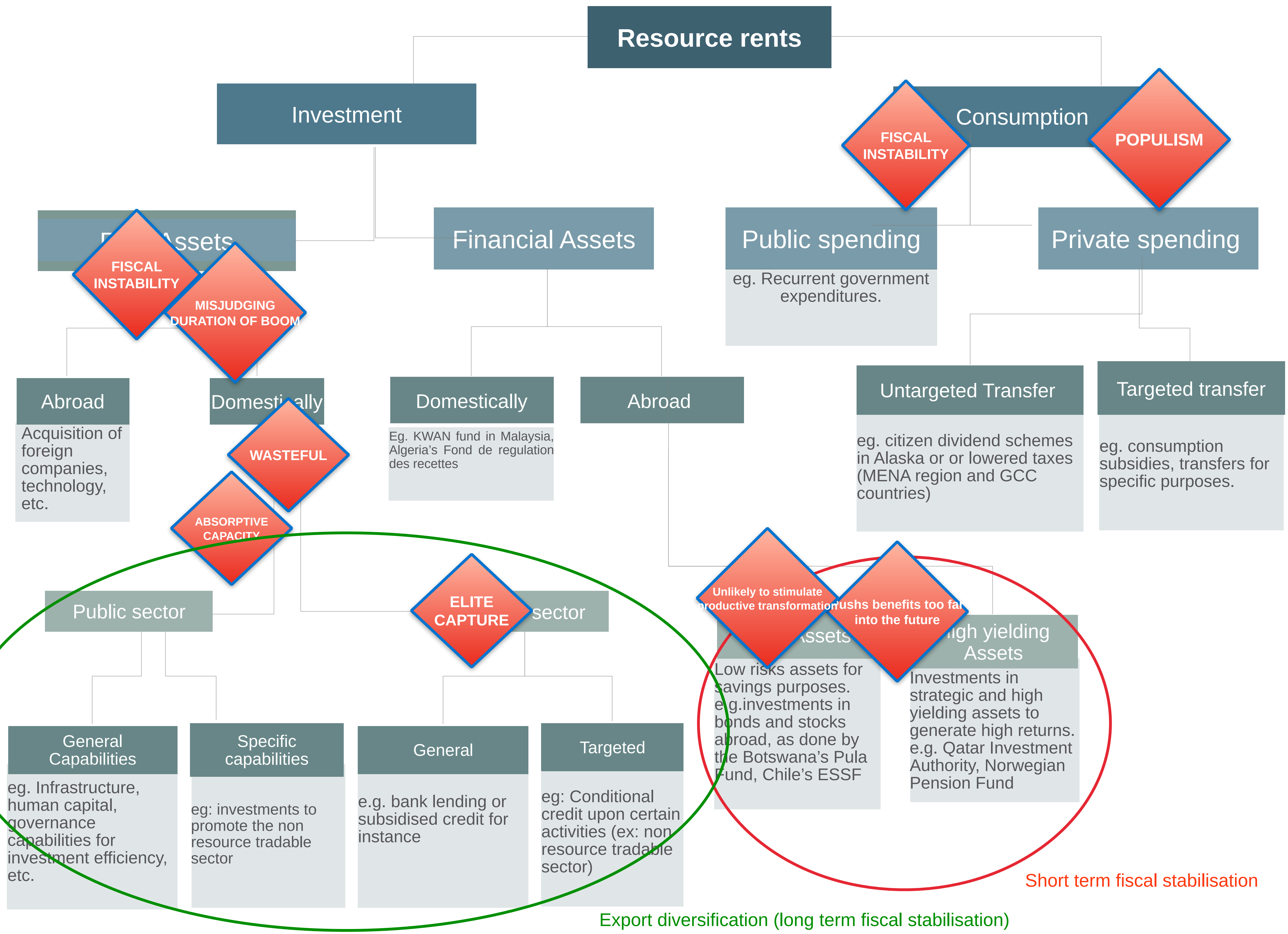

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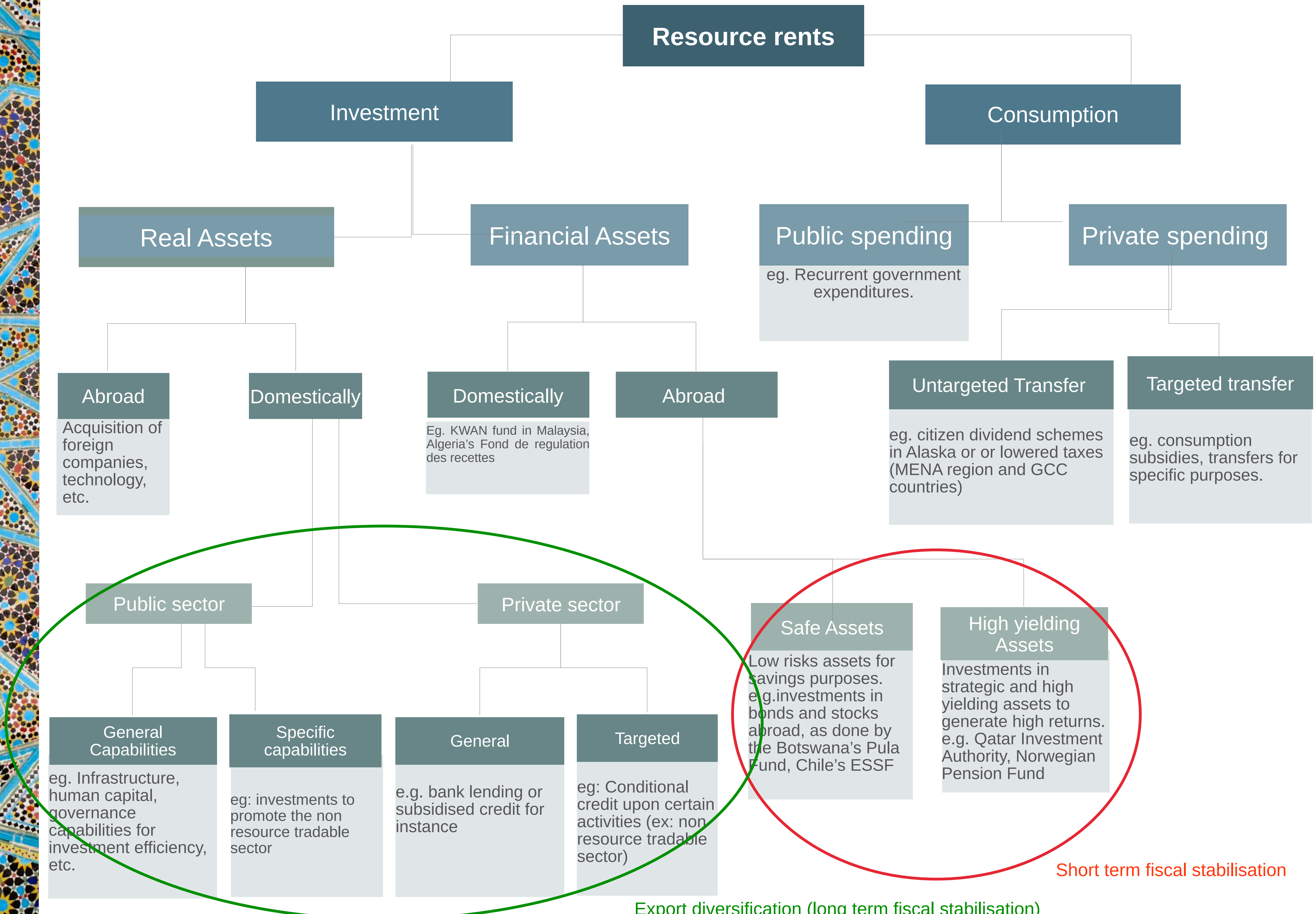


Different objectives of resource revenue management

Ultimately, choosing how to manage resource revenue is a political decision and depends not he various possible objectives of resource revenue management…

Objectives

Fiscal stabilisation
to smoothen government expenditure

Boost private consumption
by redistributing resource rents to citizens

Domestic investment (specific)
to promote economic diversification and reduce reliance on commodities for foreign exchange generation

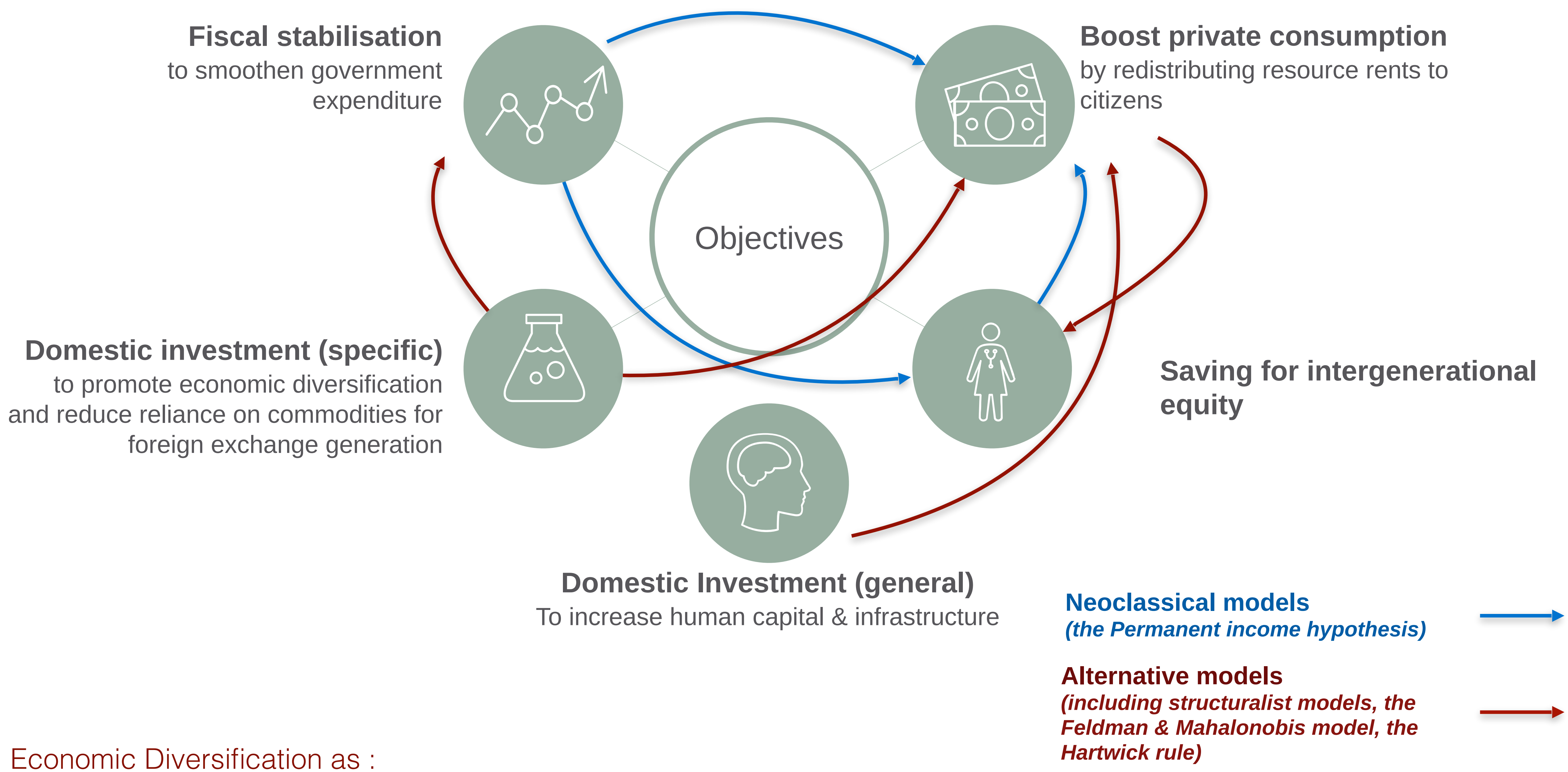
Saving for intergenerational equity

Domestic Investment (general)
To increase human capital & infrastructure

Different objectives of resource revenue management

…but these objectives are interrelated, why is why holistic approach is needed.

The way they relate to one another is viewed differently based on economic ideology.



Economic Diversification as :

- the best long-term 'fiscal stabilization' strategy
- the most sustainable way to achieve a gradual and long-run increase in private consumption.

Beyond the one-size-fits-all approach

- The standard policy advice only addresses the symptoms of the resource curse (vulnerability to commodity price volatility) but not its root causes (commodity dependence). As a result, we need to go beyond the emphasis of the “Norwegian example” to managing resource revenues, while neglects the role of the diversification of productive structures.

- **There is no *one-size-fits-all* solution,** because the way resource revenues should be used depends on several factors, which influence the trade offs between various types of investment, that are different across time and space. Such factors include:
  - **Degree of commodity dependence** (The urgency to diversify increases with the degree of commodity dependence)
  - **Savings rate to date** (Current savings rate contribute to the ability of the country to invest domestically as it is already “insured” in the case of a commodity price collapse)
  - **Investment deficit** (including low spending on human capital, education or R&D) increase the opportunity costs of resource revenue investments in financial assets overseas because funds would not be made available for domestic investment
  - **Degree of resource exhaustibility and anticipated price fluctuations** (due to changes in consumer demand or technological innovations)
  - **Institutional capacity to invest** (institutional mechanisms affect a government’s capacity to invest resource revenues efficiently)
  - **Degree of resource abundance per capita** (The opportunity cost of investment in financial assets overseas are lower for very resource rich per capita countries (e.g. Kuwait, Qatar, UAE) than medium resource rich per capita countries (Algeria, Iraq), where there is a higher urgency for employment generation outside of extractive sectors)

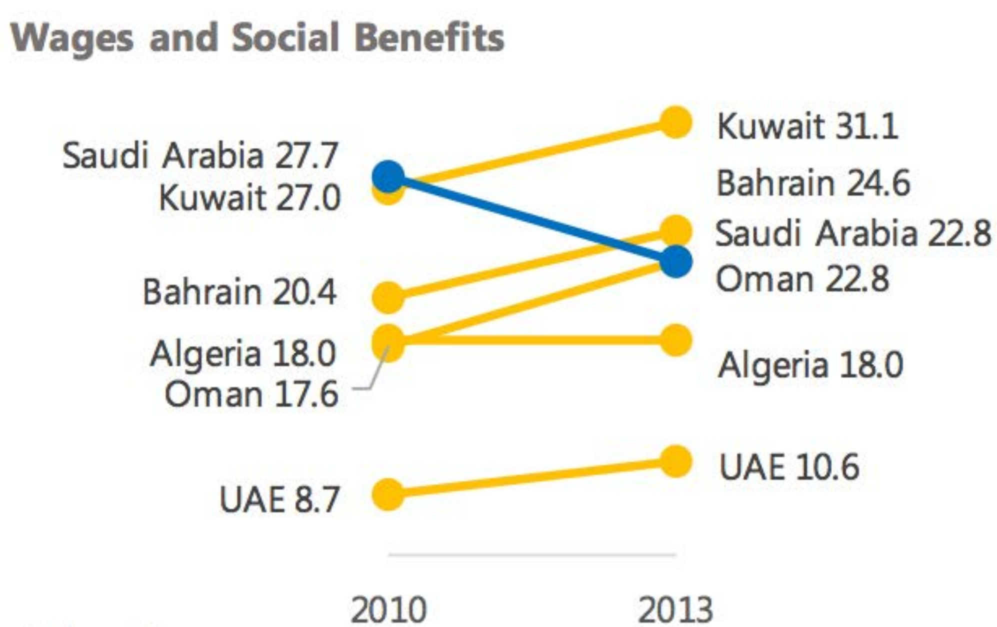
- In the MENA region, in the context of high diversification needs, resource revenue management need to be oriented towards the accumulation of productive capabilities.

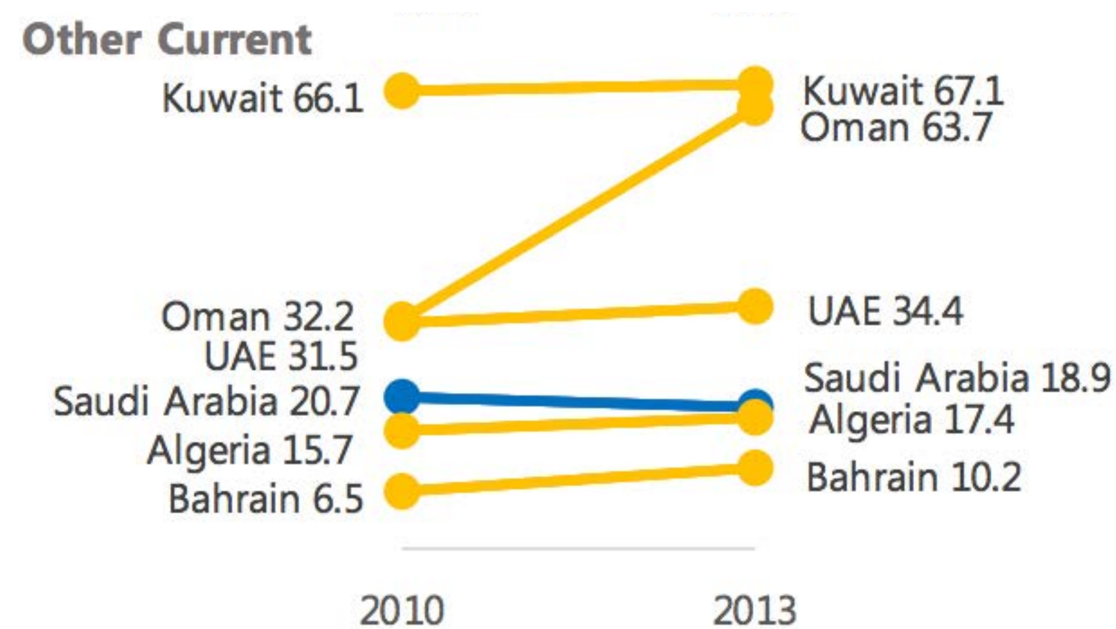
How have MENA countries managed their resource revenues to date?

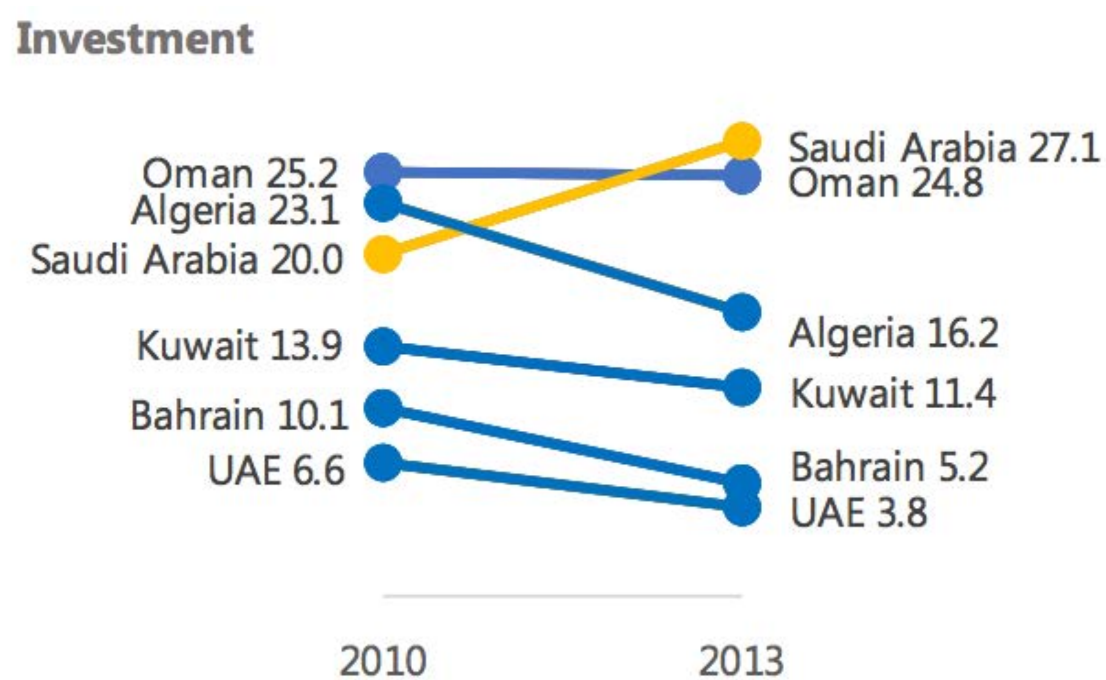
Consumption and financialization at the expense of structural transformation.

- Generally speaking, MENA countries have tended to spend their resource revenues generated by the last commodity boom by **fuelling domestic consumption,** both at the public sector and private level, rather than for investment to increase the productivity of non-resource tradable sectors.
    - Use of petroleum revenues to support citizens "from cradle to grave", by providing free education and healthcare, highly subsidised utility prices, land, and cheap financing for housing construction, low taxes as well as employment in the public sector for nationals (Malik and Nagesh, 2019).
    - Resource rich countries of MENA tend to have **larger military spending** (Ali and Abdellatif, 2013) and energy subsidies (Fattouh and El Katiri, 2013) than the rest of the world.
- Another feature of resource revenue management in the some of the resource-rich MENA countries has been the **high levels of accumulation of financial assets overseas.** The UAE, Kuwait, and Qatar in particular have accumulated very large SWFs. Such concentration of of resource revenues abroad in SWF has been a key factor constraining the ability of GCC governments to reduce overdependence on hydrocarbons revenues (Shehabi, 2019).

How have MENA countries managed their resource revenues to date?







Source: IMF (2016)

A different approach to managing resource revenues

In order to use resource revenues **to overcome domestic structural constraints** (such as low technological sophistication, limited areas of competitive advantage, low absorptive capacity), while **mitigating economic risks associated with resource revenues** (such as public investment inefficiency, absorptive capacity constraints, and Dutch disease), we suggest an novel approach that is based on the following two features:

The gradual scaling-up of domestic investments in real assets

The targeting of tradable sectors

This approach is dynamic across time because it emphasizes the gradual shift between short-term fiscal stabilization and long-term accumulation of productive capabilities. As a result, it enables short-term fiscal stabilization, while enabling countries to accumulate productive capabilities in the long-term through domestic investments.

This approach also takes account of policies to improve the country's institutional capacity to invest over time because it acknowledges the endogenous relationship between state capacity and growth by taking into account how certain patterns of resource-revenue investment can better contribute to building state capacity over time.

This approach has several benefits, such as:

- Explicitly incorporating the building of the capacity to invest (including through learning-by-doing)
- Reducing the cost of misjudging the duration of a commodity boom
- Taking into account the diminishing marginal utility of public spending and the issue of absorptive capacity
- Explicitly considering the opportunity costs associated with over-insurance through overseas financial investment of resource revenues.

Concluding remarks

- Economic diversification is urgent across the MENA region (although the degree of urgency varies across countries). Countries that are currently the most vulnerable to the vagaries of commodity dependence are Algeria, Iraq, Oman and Saudi Arabia.

- To date, almost across the board, resource revenues have been used to fuel consumption and for financial diversification at the expense of structural transformation.

- The standard policy advice is not sufficient for addressing the particular challenges faced by the resource-dependent countries of the region. Mainstream models which are based on the permanent income hypothesis are dominated by a short-term emphasis on consumption, fiscal stabilization and market equilibrium at the expense of long term structural change.

- A different approach to resource revenue management is needed to stimulate the accumulation of productive capabilities and to address the short term versus long term needs of MENA countries.

Thank you for your attention

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