Journal of Development Economics 118 (2016) 1–12

Contents lists available at ScienceDirect

Journal of Development Economics

journal homepage: www.elsevier.com/locate/devec

Petro populism☆

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ARTICLE INFO

Article history:
Received 23 February 2015
Received in revised form 27 August 2015
Accepted 28 August 2015
Available online 4 September 2015

Keywords:
Resource curse
Political economy

ABSTRACT

We aim to explain petro populism — the excessive use of oil revenues to buy political support. To reap the full gains of natural resource income, politicians need to remain in office over time. Hence, even a rent-seeking incumbent who prioritizes his own welfare above that of citizens, will want to provide voters with goods and services if it promotes his probability of remaining in office. While this incentive benefits citizens under the rule of rent-seekers, it adversely motivates benevolent policymakers to short-term overprovision of goods and services. In equilibrium, politicians of all types indulge in excessive resource extraction, while voters reward policies they realize cannot be sustained over time. Moreover, overextraction might even be reinforced as voters become better informed.

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1. Introduction

Much anecdotal evidence and an increasing number of careful empirical studies argue that economies rich in natural resources tend to save too little of their resource income. Estimates by the World Bank (2006) and Van der Ploeg (2011) show that countries with a high share of natural resource rents in gross national income (GNI) typically have lower, and often negative, genuine saving rates.[1] A main explanation of this pattern is that politicians in resource-rich countries use resource revenues to secure political support and hold on to their power. Smith (2004), Cuaresma et al. (2011), and Andersen and Aslaksen (2012) find that political leaders in oil rich countries stay longer in office. Montiero and Ferraz (2010) find the same for municipalities with oil windfalls in Brazil. Goldberg et al. (2008) argue that in the United States officials in states with mineral wealth are able to buy public support and increase their vote share. They conclude that "politicians in resource-rich states have shown considerable skill in using mineral wealth to their advantage" (p. 495). Accounts of policy in various resource rich countries by political analysts (e.g., Looney, 2007; Parenti, 2005) and in the news media (e.g., Foroohar, 2009; Lapper, 2006) commonly refer to such policies as *petro populism*.

In this paper, we analyze and aim to explain the phenomenon of petro populism. We define it as follows:

Definition. *Petro populism is the economically excessive use of natural resource revenues to buy political support.*

The term of petro populism was introduced by Parenti (2005) to describe the regime and policy of Venezuela's Hugo Chávez. Parenti vividly describes how Chávez pledged *sembrar el petróleo* — to sow the oil. According to data from the IMFs World Economic Outlook from 2011, in Venezuela government spending as a share of GDP increased by almost 10 percentage points between 2000 and 2010, with the budget deficit averaging 1.5% of GDP despite a historically high oil price for much of the decade. The World Bank (2006) calculated Venezuela's genuine saving rate at the start of that decade as −2.7% of GNI. Commentators both inside and outside of Venezuela have pointed out that Chávez's policies were overly dependent on high oil prices, and therefore unsustainable (Lapper, 2006; Parenti, 2005). Yet he won numerous presidential elections and national ballots over his 15 years in power.[2] His popularity is widely recognized as being linked to oil. *The Economist,* for instance, in their leader September 29, 2012, claims that "Had it not been for the oil boom, Mr Chávez would surely have long since become a footnote in Venezuelan history."

Other politicians commonly associated with petro populism include Mahmoud Ahmadinejad in Iran and Vladimir Putin in Russia. Looney (2007) explains how before Iran's 2005 presidential election Ahmadinejad promised to "put the oil money on everyone's dinner table," and argues that it contributed greatly to him winning the election. Despite

☆ We are grateful to Editor Gerard Padró i Miquel and two referees for comments, and for discussions with Daron Acemoglu, Jørgen Juel Andersen, Georgy Egorov, Rick van der Ploeg, James A. Robinson, Konstantin Sonin, and participants at various research seminars. Views expressed in this paper are those of the authors and not Norges Bank.

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[1] Genuine saving is traditional net saving (aggregate saving less capital depreciation), plus spending on education to capture change in human wealth, minus damages of stock pollutants, *minus the value of net depletion of natural resources*. This definition is taken from Van der Ploeg (2011) and is based on Hamilton and Clemens (1999).

[2] The only exception was the 2007 referendum to abolish term limits, although this was again voted over in the 2009 referendum and this time Chávez got it his way.

http://dx.doi.org/10.1016/j.jdeveco.2015.08.010
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a genuine saving rate of −11.5% of GNI in 2000 (World Bank, 2006), Iran's government expenditures increased by 27% during Ahmadinejad's first year in office, with observers arguing that his policies were designed to boost popular support. During Ahmadinejad's first term, the head of Iran's central bank resigned, and publicly accused the president of plundering Iran's sovereign wealth fund (Foroohar, 2009).

Under Putin, Russia's economic policy has been compared to those of Chá vez and Ahmadinejad. Foroohar (2009) refers to Putin as a "Petro-Czar" and argues that he built his popularity on oil-fueled public spending. While Russia reduced its sovereign debt from 70% to 10% of GDP during Putin's first two presidential terms, the government simultaneously promised dramatic rises in budget spending on pensions, wages for state employees, and the military. According to Goryunov et al. (2013) Russia's fiscal gap is among the largest of any developed country, despite its foreign reserves and vast energy resources.[3] In the aftermath of Putin's March 2012 election victory, the American bank Citigroup calculated that the price of oil must reach and sustain $150 per barrel for Putin to be able to fulfill his campaign promises. Other analysts of the Russian economy express concerns that, even if the government can fulfill its promises, too little of the oil revenues will remain for the country's sovereign wealth fund.[4] The attempts to use oil revenues to secure political support are thus seen as a cause of excessive spending.

These examples may lead to the conjecture that petro populism is confined to weakly institutionalized regimes, but we would argue otherwise. An illustrative case in point is Norway, whose oil management policy is often put forward as a success story. Yet this success has occurred against the backdrop of the right-wing populist *Progress Party* rising to 20–30% support in opinion polls by running on an economic platform of tax cuts and higher government spending. For example, Wiedswang describes the rise of the Progress Party in these terms, and writes (our translation from Norwegian):

The latest sharp increase in support of the Progress Party started in the 1990s, almost in parallel with the growth of the Oil Fund [Norway's sovereign wealth fund]. The party's solution to nearly all problems has been to spend oil revenues; it became more petro populist than classical right-wing populist.[5]

With the 2013 election, the Progress Party was voted into national government for the first time (with the Conservative Party). Their party leader became Minister of Finance and responsible for the Oil Fund. Our theory makes clear, however, that petro populist policies do not even require that petro populists be in power. Rather, it can be the result of political competition from such candidates.[6] Snoen for instance, notes that (our translation from Norwegian):

The petroleum revenues have fostered a class of politicians that cannot say no — and petro populism has affected far more politicians than those of the Progress Party.[7]

A key assumption in our theory is that it takes time to reap the full financial gains of petroleum resources. Decisions about extraction rates are decisions about flow variables, and the commitment problems associated with sales of property rights to oil fields became evident with the renationalizations of petroleum ownership in the 1970s. Thus, the market price of oil fields would tend to lie considerably below the present value of future oil income.[8] By implication, maintaining political influence *over time* is more valuable in oil abundant countries because holding political power in the future is necessary to reap the full benefits of oil revenues.

The core question of our analysis is how systematic overextraction of natural resources can stimulate popular support. Of course, one answer could be that citizens mistakenly perceive high public spending as strong performance by the government, and do not realize that it might be financed by overextracting natural resources. Yet, given the considerable attention to populism and excessive resource extraction in the popular press, such an explanation seems simplistic; voters are likely to be aware of these practices. We therefore propose a political economy theory of petro populism, where, in equilibrium, voters are fully aware that an excessive use of oil revenues is taking place, but still reward it. Moreover, we show that if voters initially are poorly informed about government spending on public goods, and thereafter observe it more precisely, better information may actually *increase* overextraction. The reason is that the popularity gains from goods provision increases with its visibility.

Although the connection between natural resource income and populism is novel, our paper is related to several literatures. There is a large anecdotal literature on populism, but few formal models of this phenomenon.[9] The recent paper by Acemoglu et al. (2013) represents the main exception.[10] They study left-wing populism in a setting where a rich elite has interests that are at odds with the majority of the population, and show that even moderate politicians choose a policy to the left of the median voter as a way of signaling that they are not right-wing. A bias in terms of leftist policies is preferred by the median voter because the utility loss before the election increases the probability that the politician is not right-wing and thus yields higher expected future utility. Acemoglu et al. (2013) do not discuss resource extraction. To study populist extraction and spending policies, we extend their approach to a setting where policy has dynamic effects. Another difference is that populism in their model involves lowering voters' utility before the election, while in our model populist policies entail a short-term utility gain for voters.

Our paper is also related to the equilibrium political business cycle literature, pioneered by Rogoff and Sibert (1988) and Rogoff (1990), in which good (competent) politicians might use fiscal policy before an election to signal their type to voters. However, within this tradition no papers study resource extraction as a means to finance public spending. Moreover, in Rogoff and Sibert (1988) and Rogoff (1990) there are only separating equilibria, and hence voters fully discern if an incumbent is good or bad in equilibrium. Therefore, in these models, bad politicians never pursue populist policies and are never reelected, whereas these are key equilibrium outcomes in our theory.

The resource curse literature provides a third link with our paper. Existing political economy theories of the resource curse predict that increased duration of political regimes fosters a more efficient extraction path, see, e.g., Robinson et al. (2006, 2014). Our theory demonstrates how the causality may run in the reverse direction, and also with an opposite sign of the correlation: a more inefficient extraction path may increase regime duration. Despite a large literature on the political economy of the resource curse,[11] we are not aware of other papers that investigate how the efficiency of the extraction path affects political support.

Finally, our paper relates to studies of politically motivated debt accumulation, such as Persson and Svensson (1989) and Alesina and

[3] Goryunov et al. (2013) define the fiscal gap as the difference between the present value of a government's future expenditures and its future receipts.

[4] *New York Times*, March 17, 2012.

[5] *Dagens Næringsliv*, June 10, 2011.

[6] Partly as a response to populist pressure, the Norwegian government implemented a fiscal rule for oil revenue spending in 2001. The rule is generally regarded as a good example for other resource-rich countries, but as argued by Harding and van der Ploeg (2013) it does not necessarily provide for sufficient public savings to cover future costs of Norway's aging population. It should also be noted that not a single *krone* was set aside in the Oil Fund until 1996, i.e., after Norway had been an oil producer for 25 years.

[7] *Aftenposten*, October 30, 2013.

[8] Today, with the exception of the United States, subsoil petroleum is public property in all countries.

[9] Sachs (1989) analyzes a "populist cycle," where high inequality leads to policies that make all voters worse off. Populism in Sachs's model depends on shortsighted voters, whereas we have forward-looking voters.

[10] Acemoglu et al. (2013) is a main inspiration for our analysis. Indeed, our paper can be seen as an application of their methodology to political decisions about resource extraction. However, as discussed below, we also extend Acemoglu, Egorov and Sonin's approach along several dimensions.

[11] For surveys of the resource curse literature, see Deacon (2011), Frankel (2010), and Van der Ploeg (2011).

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