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Natural resources, governance and institutional quality: The role of resource funds

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ABSTRACT

This paper investigates the relationship between resource funds, governance and institutional quality in resource-rich countries. The study is motivated by the relatively recent and inconclusive debate on resource funds and on their role in the addressing of the "resource curse". The estimation results suggest that resource funds may be associated with governance and institutional quality improvements. The analysis complements the debate on the tools of addressing the "resource curse" and on the determinants of governance and institutional quality. The findings remain important for their policy implications. The estimation results suggest that resource funds may prove useful tools in the hands of the policy makers in the attempt to address governance and institutional quality deterioration induced by resource abundance.

Introduction

Natural resource endowments can be regarded as a gift from nature which can contribute to the economic growth and development of the nations. In a paradox way, the evidence from the vast majority of resource-rich countries, especially those endowed with depletable natural resources (i.e. fuels, ores, minerals and metals), suggests that resource riches can be a "curse" rather than a "blessing". Unpredictable commodity prices with abrupt fluctuations, booms and busts in macroeconomic and fiscal balances that follow the swings in resource rents, inter- and intra-generational misallocation of resource revenues and increasing corruption, are just a few factors that have turned nature's "blessing" into a so-called "resource curse" for many resource endowed countries.

The literature to date offers a rich discussion on the causes and the solutions to the "resource curse". The set of the explanatory approaches includes structural, economic, institutional and political economy alternatives. Traditional explanations of the "resource curse" have been looking at the poor communication channels between the resource based sectors and the rest of the economy (Prebisch, 1950). Several empirical works have questioned the explanatory power of the latter emphasizing on the economic ramifications of natural resource endowments, like the declining terms of commodities trade, exchange rate pressures, price volatility, and income inequality.[1] The literature on the latter explanatory channels is extensive. Nevertheless the results remain rather inconclusive on the generalization of their applicability and on the net effects of natural resources upon growth.

In the new institutional economics institutions are regarded as a critical factor of economic growth and development (North, 1990). Following this view, the recent literature has shifted the research focus on the role of governance and institutions as determinants of economic growth and development in the presence of vast depletable resource riches (Karl, 1997; Acemoglu et al, 2001; Rodrik et al, 2004; Brunnschweiler, 2008). In a growing amount of the literature, the "curse" is regarded as the impact of resource endowments upon institutions and governance where resources induce distorted behaviours of rent-seeking, corruption and patronage. In this respect, the deteriorating governance and institutions in the presence of natural resources are considered to be *the* growth and development problem.[2]

Following the plethora of the explanations to the "resource curse", an equally rich discussion in the literature has been

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[1] See among others: Corden (1984); Auty (1993) and Engerman and Sokoloff (1997).

[2] Indicative is the work of Sala-i-Martin and Subramanian (2003), Bulte et al (2005), Auty (2006b), Collier and Goderis (2008), Karl (2008) and Kolstad and Soreide (2009).

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Table 1
List of some resource funds[a].

Country	Fund	Inception year	Commodity
Algeria	Revenue Regulation Fund (RRF)	2000	Oil
Angola	Fundo Soberano Angolano (FSA)	2009	Oil
Azerbaijan	State Oil Fund of Azerbaijan (SOFAZ)	1999	Hydrocarbons
Bahrain	Bahrain Mumtalakat Holding Company (BMHC)	2006	Oil
Botswana	Pula Fund (PF)	1996	Diamonds
Brunei	Brunei Investment Agency (BIA)	1983	Oil
Cameroon	Stabilization Fund for Hydrocarbon Prices (SFHP)	1974	Hydrocarbons
Canada[b]	Alberta's Heritage Savings Trust Fund (AHSTF)	1976	Oil
Chad	Revenue Management Plan (RMP)	1999	Oil
Chile	Pension Reserve and Social and Economic Stabilization Fund (PRSESF)	1985	Copper
Colombia	Colombia Oil Stabilization Fund (COSF)	1995	Hydrocarbons
Ecuador	FEIREP/ CEREPS[c]	2002	Hydrocarbons
Gabon	Gabon Fund for Future Generations (GFFG)	1997	Oil
Iran	Iran Oil Stabilization Fund (IOSF)	1999	Oil
Kazakhstan	National Fund of the Republic of Kazakhstan (NFRK)	2000	Hydrocarbons and metals
Kuwait	Reserve Fund for Future Generations of Kuwait (RFFGK)	1952[d]	Oil
Kiribati	Revenue Equalization Reserve Fund (RERF)	1956	Phosphates
Libya	Libyan Investment Authority (LIA)	2006	Oil
Malaysia	Terengganu Investment Authority (TIA)	2008	Hydrocarbons
Mauritania	Mauritania National Fund for Hydrocarbon Reserves (MNFHR)	2006	Hydrocarbons
Mexico	Mexico Stabilization Fund (MSF)	2000	Oil
Nauru	Nauru Phosphate Royalties Trust Fund (NFRTF)	1969	Phosphates
Nigeria	Petroleum Trust Fund (PTF)/Excess Crude Account (ECA)	1995/2004[e]	Oil
Norway	Norway Government Pension Fund (NGPF)	1990	Hydrocarbons
Oman	State General Reserve Fund (OSGRF)	1980	Hydrocarbons
Papua New Guinea	Non-renewable Resources Stabilization Fund (PNGNRRSF)	1974	Minerals
Peru	Peru Stabilization Fund (PSF)	2000	Hydrocarbons, ores and metals
Qatar	Qatar Investment Authority (QIA)	2003	Oil
Russia	Oil Stabilization Fund of the Russian Federation (OSFRF)[f]	2004	Hydrocarbons
Sao Tome and Principe	The Sao Tome and Principe Oil Fund (STPOF)	2004	Hydrocarbons
Saudi Arabia	Saudi Arabia Monetary Agency (SAMA)	1974	Oil
Sudan	National Revenue Fund (SNRF)	2004	Oil
Timor Leste	Timor Leste Petroleum Fund (TLPF)	2005	Hydrocarbons
Trinidad and Tobago	Heritage and Stabilization Fund (HSF)	2000	Hydrocarbons
Turkmenistan	Foreign Exchange Reserve Fund (FERF)	1995[g]	Hydrocarbons
UAE[h]	Abu Dhabi Investment Authority (ADIA)	1976	Oil
USA[i]	Alaska Permanent Fund (APF)	1976	Hydrocarbons
Venezuela	Investment Fund for Macroeconomic Stabilization (FIEM)/Macroeconomic Stabilization Fund (FMS)[j]	1998/2003	Hydrocarbons
Yemen	Social Development Fund (SDP)	1997	Hydrocarbons

[a] Source: Individual funds' web sites, Sovereign Wealth Fund Institute (2010), Truman (2008) and Kalyuzhnova (2006). For Colombia and Peru data on inception years are taken from Filc and Scartascini (2007). Data on Sao Tome and Principe fund inception year are from Bell and Faria (2005). The list includes funds based on depletable resources that existed by 2010.

[b] The government of Nunavut (Canada) has established a savings fund based on oil revenues in 1990, the Nunavut Trust Fund (see Kalyuzhnova, 2006).

[c] In June 2002 the Congress approved the establishment of the oil fund FEIREP (Fondo de Estabilizacion, Inversion Social y Productive y Reduccion del Endeudamiento Publico). In December 2005 FEIREP was liquidated and its net revenues were transferred to CEREPS (Cuenta de Establizacion y Reduccion del Endeumento Publico, Reactivation Productive y Social) a specially designed account held at the Central Bank. In April 2008 the national assembly decided to eliminate the oil funds and the net revenues from crude oil were transferred to the government budget (Gallardo, 2009).

[d] In 1952 the Kuwait Investment Board was established. This has been followed by a series of other relevant establishments. The Reserve Fund for Future Generations for Kuwait continuing earlier establishments was established in 1976.

[e] Nigeria has been altering its fund setting policies many times. Following a series of alterations, the Petroleum Trust Fund, established in 1995, was replaced by the Excess Crude Account in 2004.

[f] In 2008 the fund was dismantled into two separate and newly established funds, the Reserve Fund and the National Welfare Fund.

[g] The origins of the Foreign Exchange Reserve Fund date back in 1989 when the Soviet Central Bank granted general licence to the Turkmen authorities to manage foreign currency at the Turkmen commercial bank. Following the collapse of the Soviet Union, by 1992 the money was completely moved to Vnesheconombank Turkmenistan and later to the Central Bank. Since 1995, money has been deposit in the Deutsche Bank under the direct and absolute control of the late President Niyazov (Kalyuzhnova, 2008).

[h] The UAE operate several oil based funds. The ADIA is the largest fund in terms of accumulated assets as of 2010 (Sovereign Wealth Fund Institute, 2010).

[i] Several USA states have established resource funds (Texas: Texas Permanent School Fund, 1854-Oil; Wyoming: Permanent Wyoming Mineral Trust Fund, 1974-Minerals; Alabama: Alabama Trust Fund, 1985-Hydrocarbons).The Alaska fund is the largest fund in terms of accumulated assets as of 2010 (Sovereign Wealth Fund Institute, 2010).

[j] FIEM was replaced by FMS in 2003.

developed regarding the solutions to the latter. These have been looking at the pricing and taxing mechanisms of the natural resources (Dasgupta and Heal, 1979; Dixit and Newbery, 1985; Karp and Newbery, 1991), at the optimal extraction of natural resources (Hotelling, 1931) and at the optimal intra- and inter-generational allocation of resource revenues (Takizawa et al, 2004). The literature to date has been looking extensively at these alternative suggestions, at their applicability and at their efficiency in addressing the "curse". The main criticism regards their rather normative nature and their limited practical implementation (van der Ploeg, 2010).

A relatively recent approach has been proposing the employment of explicit tools of economic policy such as resource funds. Resource funds (hereafter RF) are directly or indirectly government owned and controlled special purpose funds.[3] They are

[3] See: Truman (2008), Mattoo and Subramanian (2008) and Tsani et al (2011).