Resource wealth and direct dividend payments: what's missing?

by Ryan Edwards

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The idea of reversing or avoiding the so-called 'resource curse' by directly transferring resource revenues to citizens is gaining traction in policy circles around the world. In this post, I explain why I think such transfers should be primarily seen as a broader political tool to deliver good policy, rather than a stand?alone panacea or the 'best practice' approach to managing natural resource wealth. Critical elements appear to be missing from most existing and proposed resource-related direct dividend payments (DDP) schemes, but this need not be the case. I focus on the Center for Global Development's (CGD) clear and compelling 'Oil?to?Cash' proposal, but my thoughts apply more broadly to other resource-related direct transfer models.

The Direct Dividend Payment proposal

CGD's 'Oil-to-Cash' proposal is summarised as:

> *Putting these two trends—a greater understanding of the resource curse and growing innovation with cash transfers—together in a new model for natural resource management in resource-rich, poorly governed states: give the revenues to citizens in a regular, universal, and unconditional cash transfer. Rather than put the funds in the budget (and hope that they trickle down to the people) or into a savings fund (and hope they are used widely in the future), this would put the cash directly into the hands of the people.*

Firstly, let's be clear that this approach is not only applicable for resource?rich, poorly governed states. Resource sector interest groups—whether government or private sector—are formidable forces that protect their rents at virtually all costs, in countries of all income levels. Failed attempts to implement resource rent-related reforms for Australian on?shore assets (most recently with the repealed Minerals Resource Rent Tax (MRRT)) are but one example, and a stark contrast to the Alaskan Permanent Fund, whose success has been largely attributed to the politics of the dividend-based design.

Secondly, I agree with the four rationales in the CGD proposal, and cannot fault their rebuttals to possible objections. I will not repeat them here. Rather, I'll focus on what I see as a slight conceptual gap in this discussion—deliberate or intentional—related to more basic principles of managing resource wealth.

Back to basics: five key criteria for managing resource wealth

Here I lean on the shoulders of a true giant in this area, Professor Max Corden (one of the two eminent Australian economists that my Department at ANU is named after), reflecting on a discussion we had when he visited the ANU a few months back. The repeal of Australia's MRRT and the debates around Papua New Guinea's (PNG) sovereign wealth fund (SWF) got me thinking about whether a DDP-type model might be a better way forward: in Australia, to neutralize some of the toxic politics of resource reform; and in PNG, for the governance reasons outlined in the CGD paper. I was keen to hear Max's views on the idea. He was not familiar with the proposal, but immediately took me back to 'first principles' and quickly distilled a burgeoning academic and policy literature and debate into three simple and important points. He suggested to me that whatever this new dividend is, it should probably do three things:

1. Avoid Dutch disease [1] problems;
2. Ensure the benefits of natural resource wealth are spread to the whole population (i.e., current generational equity); and
3. Ensure that future generations also benefit and it is not 'wasted now' (i.e., intergenerational equity).

These three basic goals are uncontroversial and hearing it come from Max made me realise that these principles should remain key considerations when thinking about and designing new resource policies. But, I'll add two other points to Max's list:

4. Minimising macroeconomic volatility, now regarded as the 'quintessence' of any 'resource curse'; and
5. Political feasibility, an issue sometimes neglected by economists like me.

There is certainly a trade-off between these five goals, and historically they have

been difficult to align. For example, a mining tax or royalty does little to strengthen accountability, give citizens agency over the fruits of a boom, or offset any Dutch disease effects. Likewise, SWFs typically do not benefit the existing generation directly, except through indirect economic benefits and perhaps through government spending.

How do DDPs measure up against these five criteria?

As a proposal for managing resource wealth, DDPs should still be considered against these five criteria. We know that the DDP proposal scores highly against the fifth criterion (politics), but what about the other four?

1. It is not clear how DDPs would help deal with Dutch disease issues, and it could either mitigate or exacerbate such problems. However, there are certainly a range of complementary polices to deal with Dutch disease issues that could be embedded in or alongside a DDP scheme: see point 3 below.
2. CGD's baseline DDP proposal ensures that the current generation, in its entirety, benefits fairly from the resources—no question. All citizens should have an equal right to the benefits of national natural wealth and this aspect of the proposal has a strong ethical appeal. An equal payment also disproportionately benefits those at the lower end of the income distribution, so has strong poverty reduction and inequality-reduction arguments.
3. While DDPs certainly are fair to the current generation, it is much less clear whether the benefits will be spread to future generations. This depends on a lot of tenuous causal links and assumptions. For example, will the DDP boost general revenue? If so, will general revenue be spent on foundational investments? Will such investments drive growth or benefit future generations? Will the social contract and institutions be strengthened as much as envisioned? If so, will this institutional change have as much, if not greater, indirect benefits for future generations than alternative approaches? Will the immediate boost to current incomes also benefit future generations through, for example, economic growth and the intergenerational transmission of higher per capita incomes? I don't think we have sufficient information to answer most of these questions just yet, so a hybrid model that also saves or makes long-term investments might be more appropriate.
4. If the distribution of DDPs track extraction, profits, resource revenues, or similar indicators, the transfers are likely to be pro-cyclical, and exacerbate any 'resource curse' that has not been 'cured' by the DDP program. I understand that this has been the experience in a number of countries implementing similar schemes, but this need not be the case. For example, the transfers might be delayed: a de-politicised form of counter-cyclical fiscal policy, with the timing determined by an independent board analogous to a central bank board of governors. Every citizen might have an account with statements analogous to superannuation or tax accounts for transparency and to assist in justifying delayed distribution to the public. There are plenty of other policy tools to deal with volatility, particularly related to the exchange rate and exposure to commodity prices, which could easily be integrated into or alongside a DDP scheme.

The DDP idea is strong and good policy: politically powerful, and immensely flexible. But I am not as quick as its authors to (perhaps implicitly) rule out other options around its design.

For example, a SWF could certainly be used with the DDPs (as it is in Alaska) to sterilize the Dutch disease, generate reserves to buffer the economy from volatility, and to share resources with future generations. Countries currently distributing pro?cyclical dividends could quite easily reverse this trend. In low income countries, countries with high inequality, or countries with high poverty rates, it may be better not to distribute an equal amount to everyone, or even to cover everyone. Lastly and on a less optimistic note, there are still some clear shortfalls that need to be addressed. In particular, a robust and sustainable policy where every citizen directly benefits from extracting fossil fuels might be very dangerous climate policy and require a lot more thought and open policy debate.

My punchlines are as follows:

- The DDP model is a powerful proposal for all the compelling reasons presented in the CGD proposal, particularly in terms of taking the toxic politics out of natural resources reform.
- A DDP-type model should be an option on the table moving forward in Papua New Guinea, Australia and other resource-rich countries in the Asia Pacific region.
- The political power of DDPs would be wasted if not used as a vehicle to achieve other important policy goals. For this reason, DDPs should be conceived as a flexible model, and part of a hybrid approach, not as a one-size-fits-all and stand-alone solution.

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[1] The Dutch disease can occur when increased resource exports generate large balance of payments surpluses; this appreciates the real exchange rate and increases relative prices for non-tradable inputs to other sectors. When these exchange rate and price effects are coupled with higher demand from a mining boom, other trade-exposed sectors are less competitive and often permanently displaced.

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