Is Australia just a “two-speed economy” or is it about to suffer from an attack of “resource curse”

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- Presentation outline

  - Definitions
    - “Two speed economy”
    - “Resource curse”

  - Context
    - A brief history of “resource curse”
    - Recent Australian experience of the “two-speed economy”
    - A serious attack of resource curse looming?

  - Solutions?

- Definitions: “Two speed economy”
  - Some sectors growing faster than others
  - Some States growing faster than others
  - But (allegedly) all eventually benefit

- Definitions: “Resource curse”

  - Large windfall revenues should be good news
    - “Money can’t buy you happiness but it is a good down payment”
    - Breaks you out of the vicious circle of poverty
    - Generates a “big push”

  - But casual empiricism suggests the opposite – resource rich countries experience a worse economic performance

  - This has become known as “resource curse” or the “paradox of plenty”

- Context: Resource curse – a brief history (1)

Humankind has long had a strong “puritan” streak

- “… when I have brought them into the land … that floweth with milk and honey … they shall waxen fat, then will they turn unto other gods” (Deuteronomy 31:20)
- Ibn Khaldun (1332-1406) – His fifth stage of the State = “waste and squandering”
- Jean Bodin (1530-1596) – “Men of a fat and fertile soil are most commonly effeminate and cowards whereas … a barren country makes men … careful, vigilant and industrious”
- Spanish experience in the 17th Century following the influx of wealth from the New World

- Context: Resource curse – a brief history (2)

- 1950's and 1960's – the "Periphery" (primary product producers) disadvantaged compared to the "Centre" (industrial product producers) because of deteriorating terms of trade.
  - need more primary products to buy less industrial goods (Singer-Prebisch thesis)

- More recently, interest revived by the oil price shocks of the 1970s

- Context: Resource curse – a brief history (3)

- The curse of oil (Middle East Money March 1975)
  - "… oil to the Arab World in the twentieth century would be what the Mongol hordes were to the Arab world in the thirteenth century – namely an unmitigated disaster".

- The transmission mechanisms of a resource curse…

The Transmission Mechanisms

- Economic
  - Dutch disease
  - Crowding out
  - Increasing role of the state
- Socio-cultural
  - Rentier societies
- Political
  - Governance and corruption
  - Pressure to spend

The Transmission Mechanisms: Dutch disease

- Named after experience of the Netherlands following the discovery of the Groningen Gas Field in 1959

- Three sectors – non- traded; traded = lagging sector plus booming sector (minerals or petroleum). Three effects
  - Resource movement effect – labour shifts to the booming traded sector = direct deindustrialization effect.
  - Spending effect – Increased revenue increased demand for labour in the non-traded sector shifting labour from the lagging sector =indirect deindustrialization.
  - Exchange rate effect Increased demand for non-traded services increases prices therefore appreciation of the real exchange rate. Reinforced if the nominal exchange rate appreciates as a "petro-currency"

- The claimed result the traded lagging sector contracts – For Holland (and the UK) = manufacturing. For OPEC = agriculture. So what??

- So what ? Dutch Disease = Future problems given the future of commodity revenues which = P x Q
  - Mineral depletion = declining Q
  - Technical changes reducing demand = declining Q
  - Commodity prices - Long-term trend is for a decline
    - » the Singer-Prebisch Thesis
  - Eventually mineral/petroleum revenues fall in an economy where the traded sector has been weakened

The Transmission Mechanisms

- Economic
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  - Pressure to spend

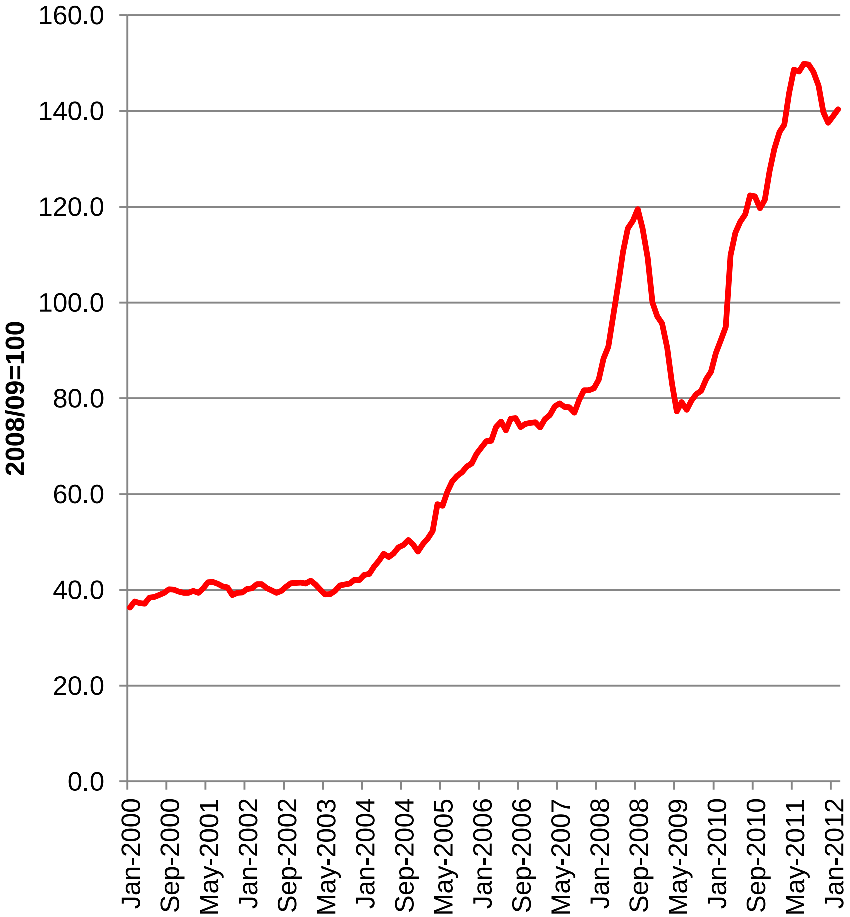
- The Context – Recent Australian experience of the “two-speed economy”

  – “In fact, Australia has long been a two-speed economy … Differences in state employment and output growth have been larger than average in recent years but by no means exceptional” Phil Garton, The resource boom and the two-speed economy. Economic Roundup **Issue 3 2008** Australian Government, the Treasury

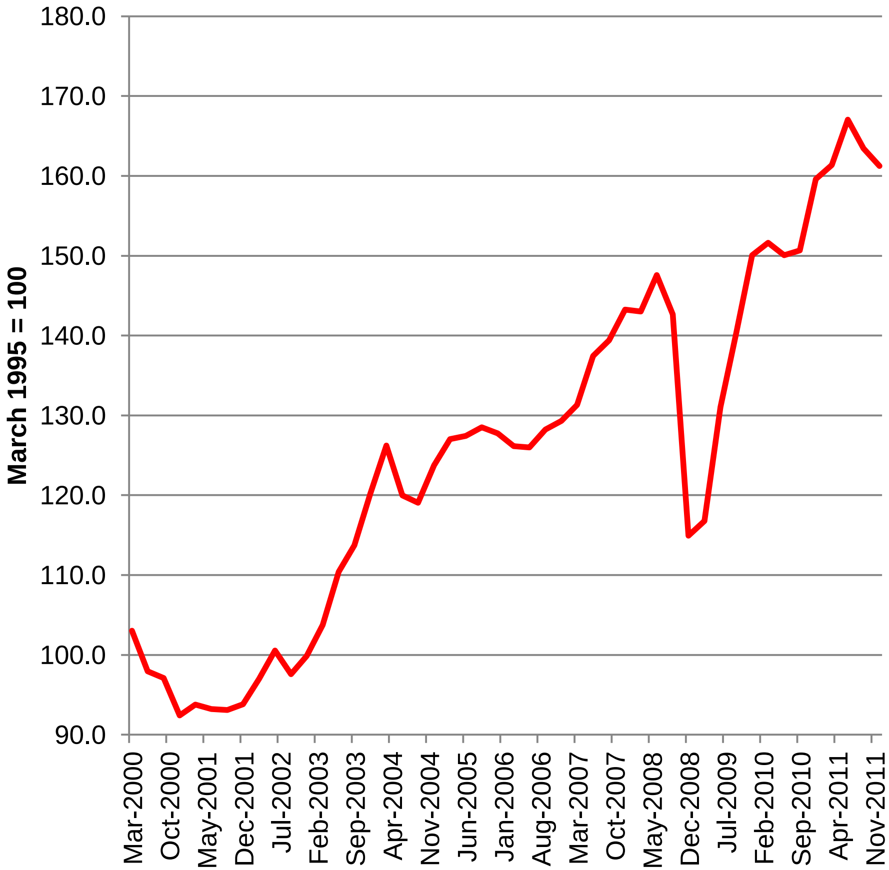
  – Since then … in 2011 final demand grew by –
    - Western Australia 16.4 percent
    - Queensland 9.3 percent
    - Rest of Australia 1.3 percent

- The Context – A serious attack of resource curse looming?

RBA Commodity prices

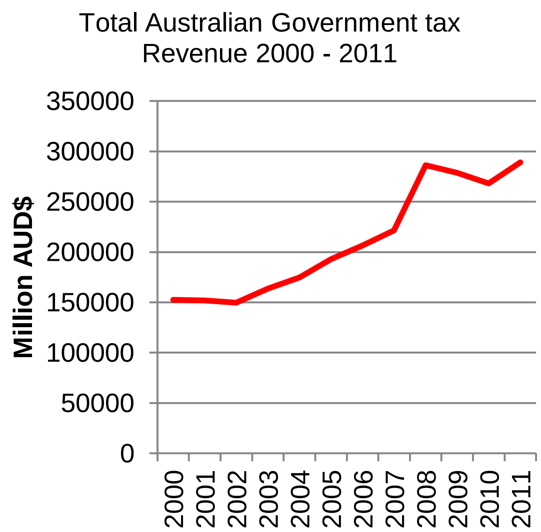


Australian $ real exchange rate (trade weighted)

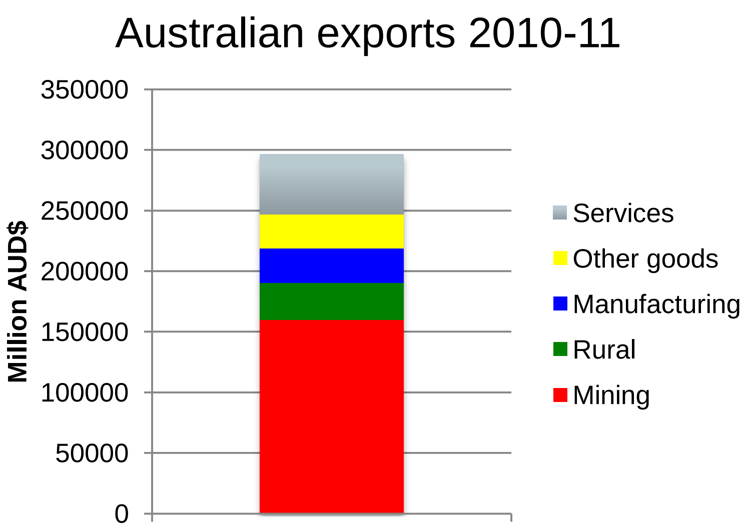


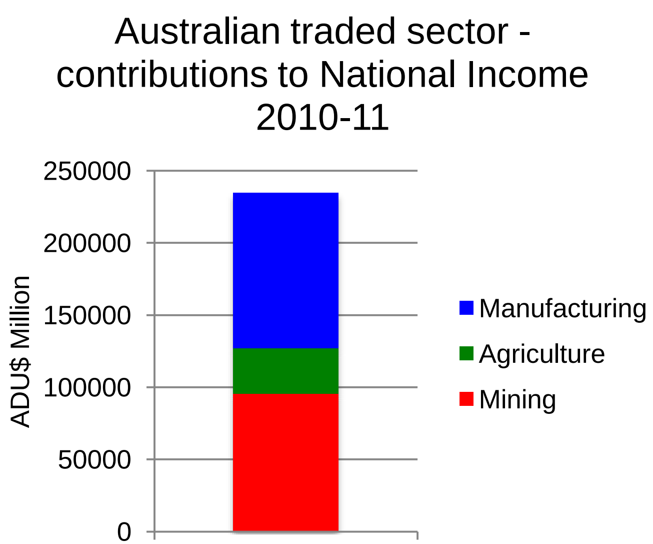
The Context – A serious attack of resource curse looming?

- Influx of revenue expected after 1st July – Mineral Resource Rent Tax = AUD$12 billion (2013-14) plus extended Petroleum Resource Rent Tax – AUD$??



- Economic patterns





- Solutions from the literature

  1. Slow the appreciation of the real exchange rate
     - Sterilize the inflow of revenue from natural resources

  2. Increase the competitiveness of the lagging traded sector
     - Invest in infrastructure
     - Invest in education

  – Need an Australian Natural Resource Revenue Fund?

- A Natural Resource Revenue Fund: The Case For
  - In Australia, the mechanism exists – Future Fund created 2006
  - It can sterilize revenue inflows and smooth revenue volatility
  - Investing abroad can limit exchange rate appreciation
  - Saves for future generations
  - Can focus investments to specific sectors
  - Can be used to manage current expectations