

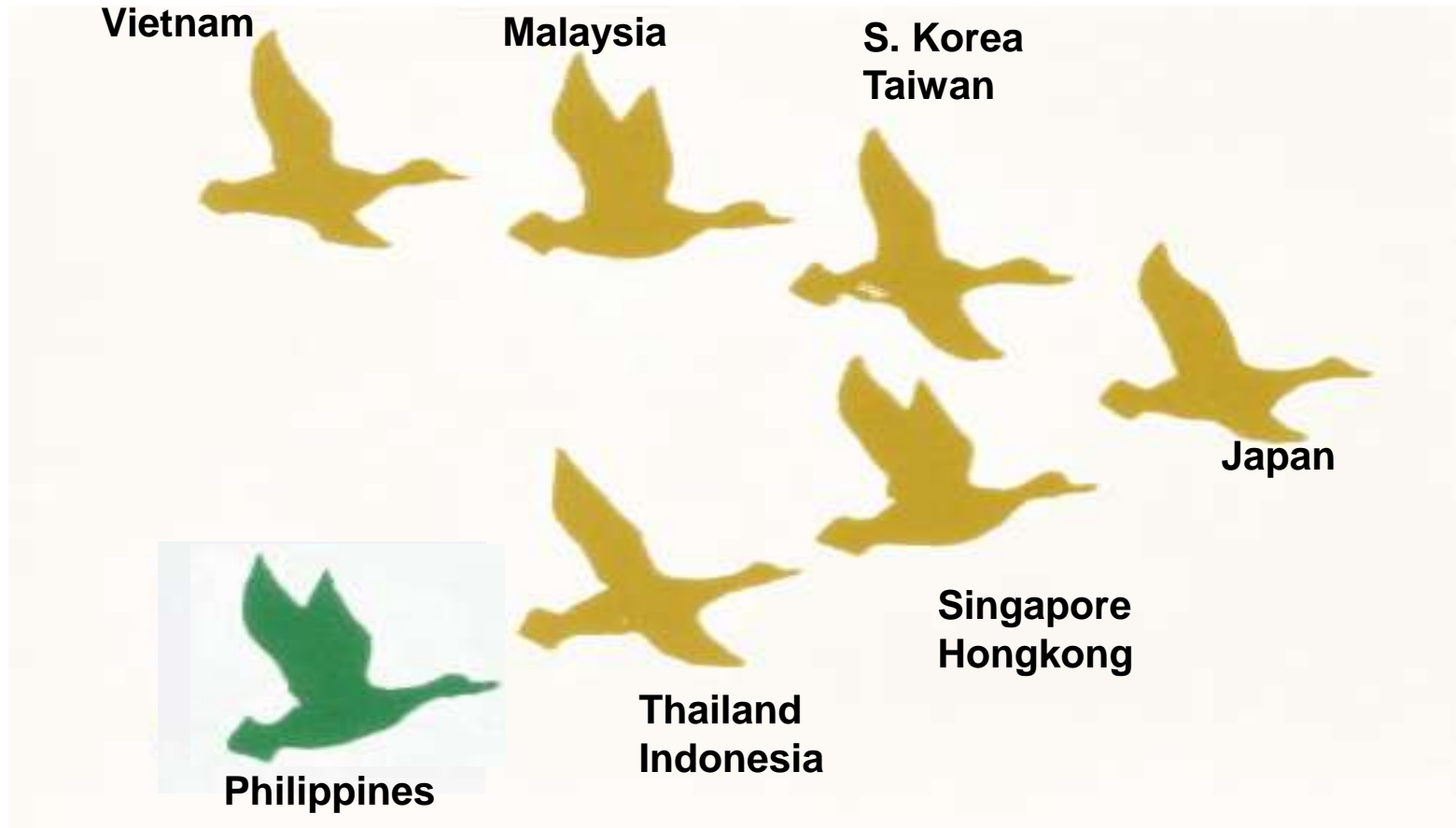


# **The curse of abundance: A Philippine Illustration**

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# Dynamic Comparative Advantage: Structural Transformation



**East-Asian miracle: manufactured exports is the engine of growth. Network externalities led to endogenous growth.**

# Philippines: A development puzzle

<b>THEN (1960s)</b>	<b>GDP per cap</b>	<b>Agri</b>	<b>Industry</b>	<b>Pop</b>	<b>Secondary</b>	<b>College</b>
<b>South Korea</b>	<b>\$ 640</b>	<b>37%</b>	<b>20%</b>	<b>28 Mn</b>	<b>25%</b>	<b>5%</b>
<b>Philippines</b>	<b>\$ 640</b>	<b>26%</b>	<b>28%</b>	<b>31 Mn</b>	<b>25%</b>	<b>13%</b>
<b>NOW (00s)</b>	<b>GDP per cap</b>	<b>Agri</b>	<b>Industry</b>	<b>Pop</b>	<b>HDI Rank</b>	
<b>South Korea</b>	<b>\$12,307</b>	<b>4%</b>	<b>40%</b>	<b>47 Mn</b>	<b>26</b>	
<b>Philippines</b>	<b>\$1,058</b>	<b>15%</b>	<b>32%</b>	<b>81 Mn</b>	<b>90</b>	

Source: Lucas, 1993; WDI 2007; and UNDP HDR

# Why the Ph.'s slow growth?

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- **Bad policies?: Premature industrialization (Power and Sicat 1971, Bautista, Power and associates 1979, Clarete and Roumasset 1987)**
- **Bad institutions? (Stern 2005, Acemoglu & Robinson 2008, North et al. 2009).**
- **Both?**

# Dilemma

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- **Policies and institutions are endogenous.**
- **How can you get prices and institutions right if you don't know how and why they are wrong?**

- ❖ **One possible cause of bad institutions: the **generalized resource curse**.**
- ❖ **While not the only cause of bad institutions, exploring the **curse of abundance** may help in the search for fundamental sources of institutional effectiveness.**

# Sectoral/Resource Boom

- **Sectoral boom – price  $\uparrow$ , cost  $\downarrow$  (Cordon and Neary 1982)**
  - Extractive: gas discovery (Dutch disease)**
  - Non-extractive: industrial innovations**
- **Resource boom: agriculture, minerals, and fuel (Sachs and Warner, 1995)**

**CURSE: Windfall wealth becomes detrimental to economic development.**

# Two main curse mechanisms

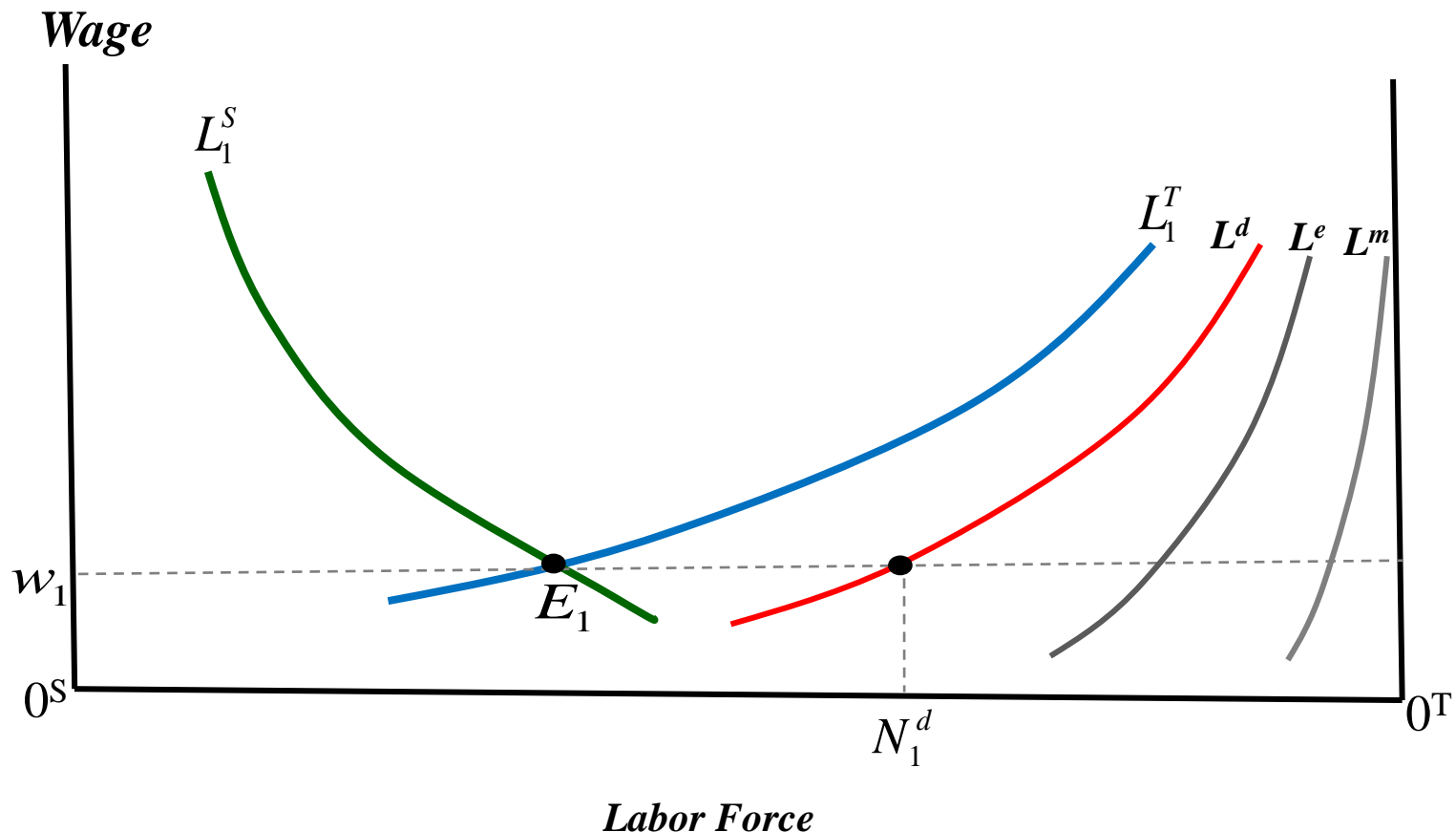
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1. **Appreciation of the Real Exchange Rate shrinks the manufacturing engine-of-growth (Dutch disease)**
2. **Increase rates of return to rent-seeking, strengthening iron triangle**

**Both induce economic inefficiency  
and lower growth rates**

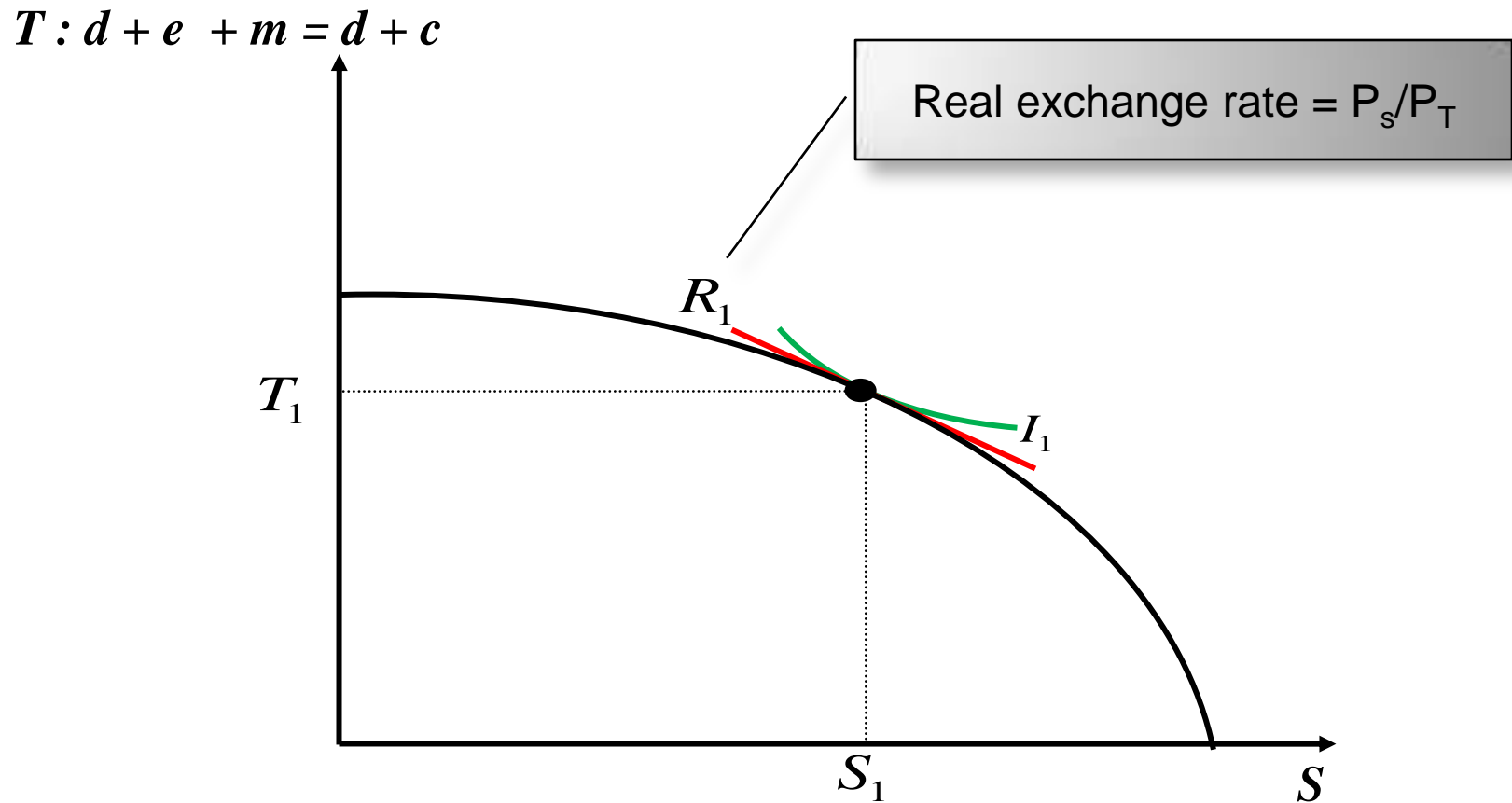


# Pre-boom equilibrium: Labor market



- Non-traded: Service sector (S)
- Traded sectors (T): domestic car production (*d*), electronics (*e*), and minerals (*m*)

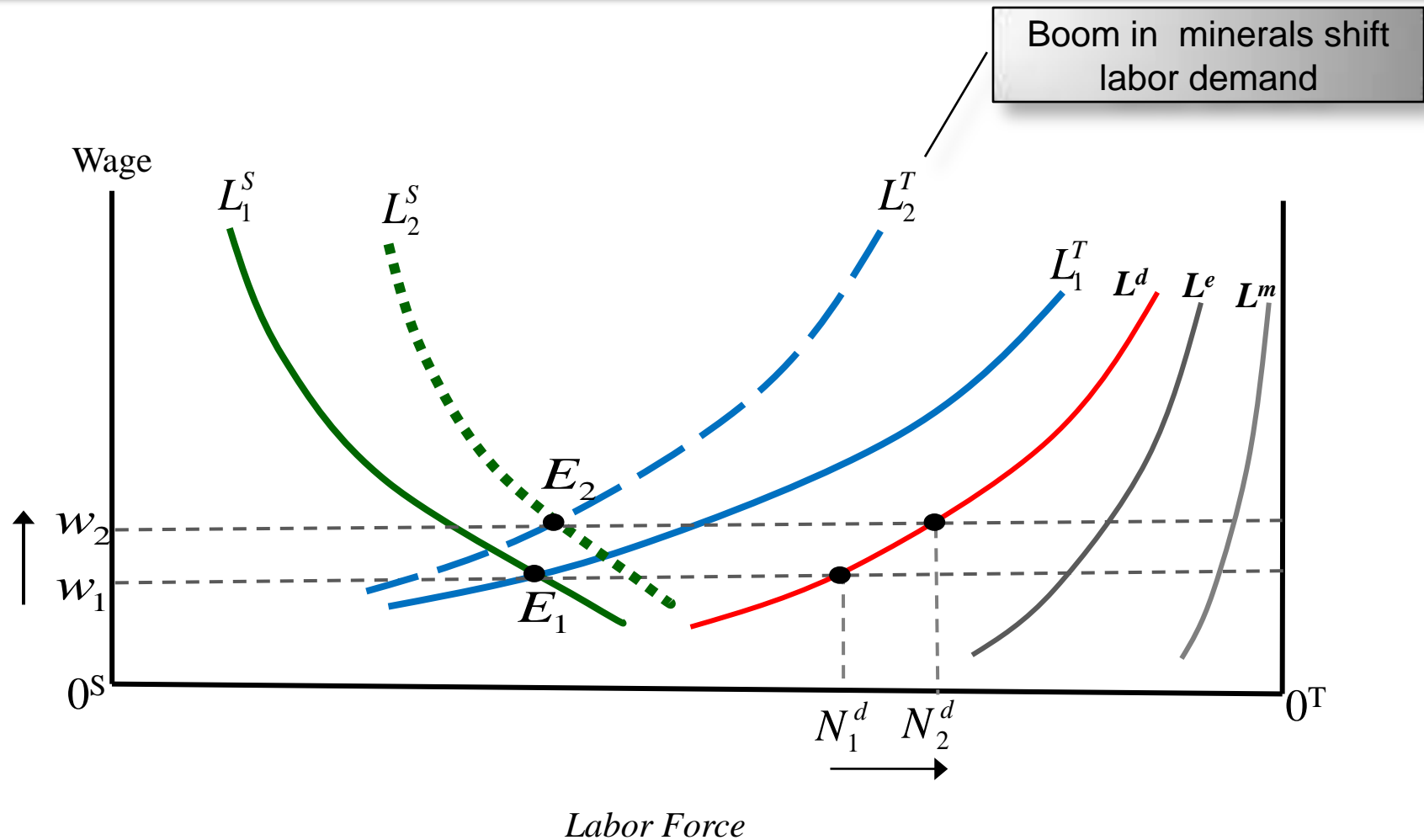
# Pre-boom equilibrium: Economy



Traded sub-sectors are lumped into a single Hicksian composite good.

- Production side: domestic production of cars ( $d$ ) + electronics ( $e$ ) + minerals ( $m$ )
- Consumption side:  $d$  + imports of cars ( $c$ )
- Exports = Imports:  $e + m = c$

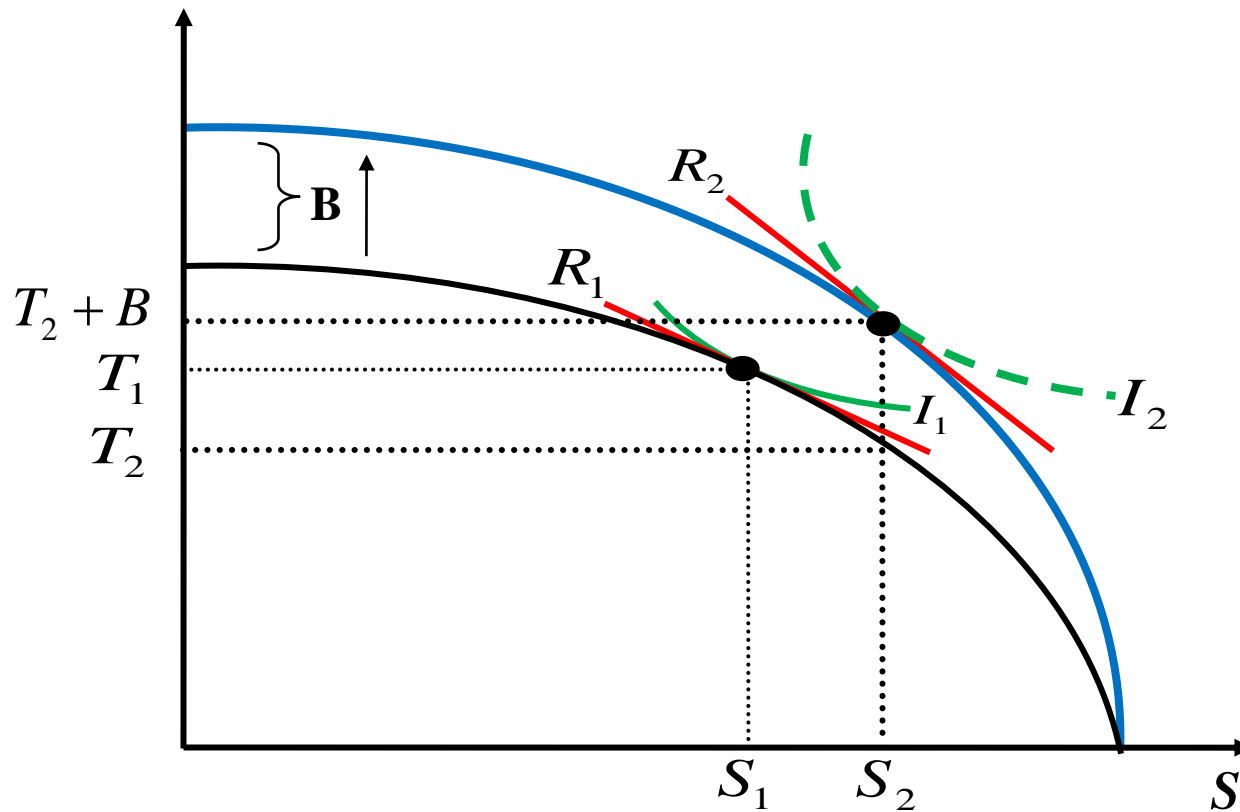
# 1) Dutch Disease: Lagging sector gets squeezed



**Losers: domestic producers of cars and electronics**

# 1) Dutch Disease Mechanics: Real Exchange Rate Appreciation

$$T : d + e + m = d + c$$



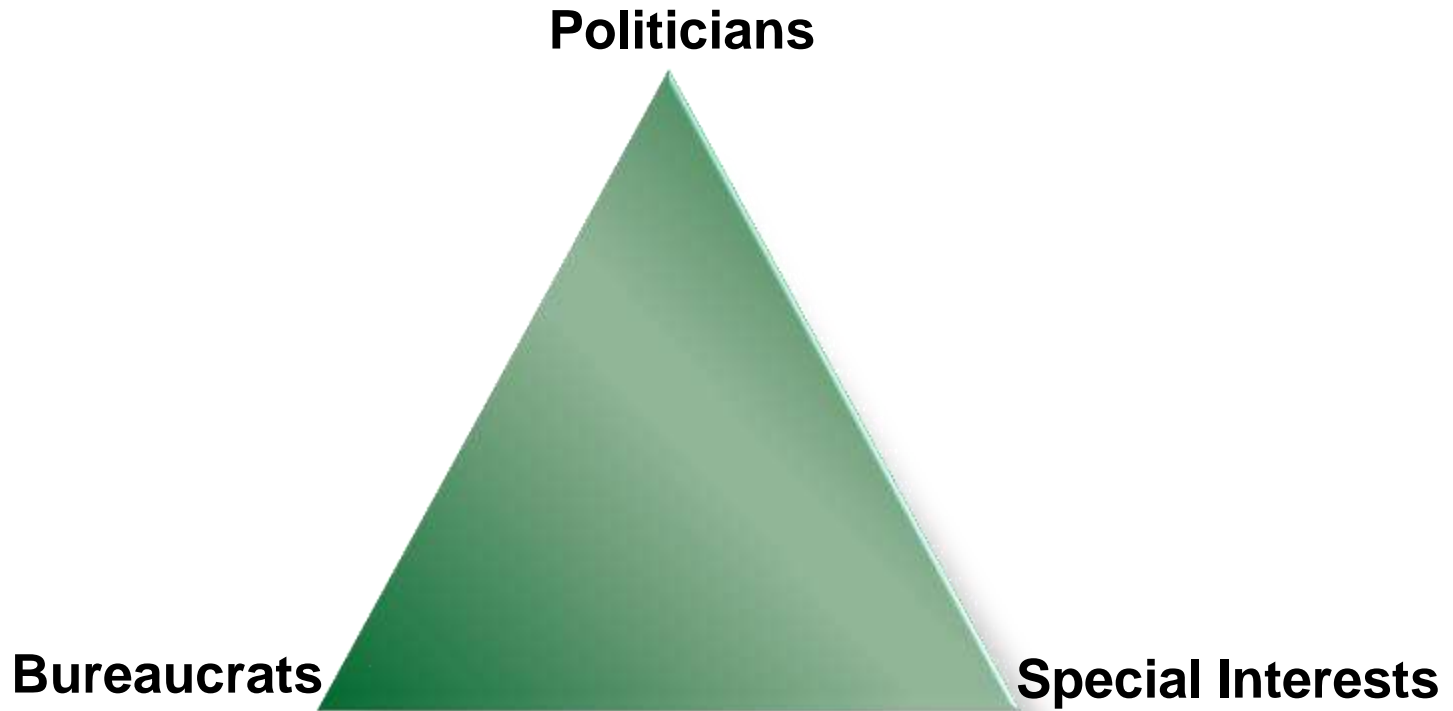
RER appreciation *per se* is not a “disease” but an economy’s statically efficient response to changing relative prices.

# Why is it a disease?

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- **Dynamic effect can be negative.**
- **Specialization and learning by doing (external economies) are undone in the lagging manufacturing sector (van Winjbergen 1984, Krugman 1987).**

## 2) Strengthening of Iron Triangle



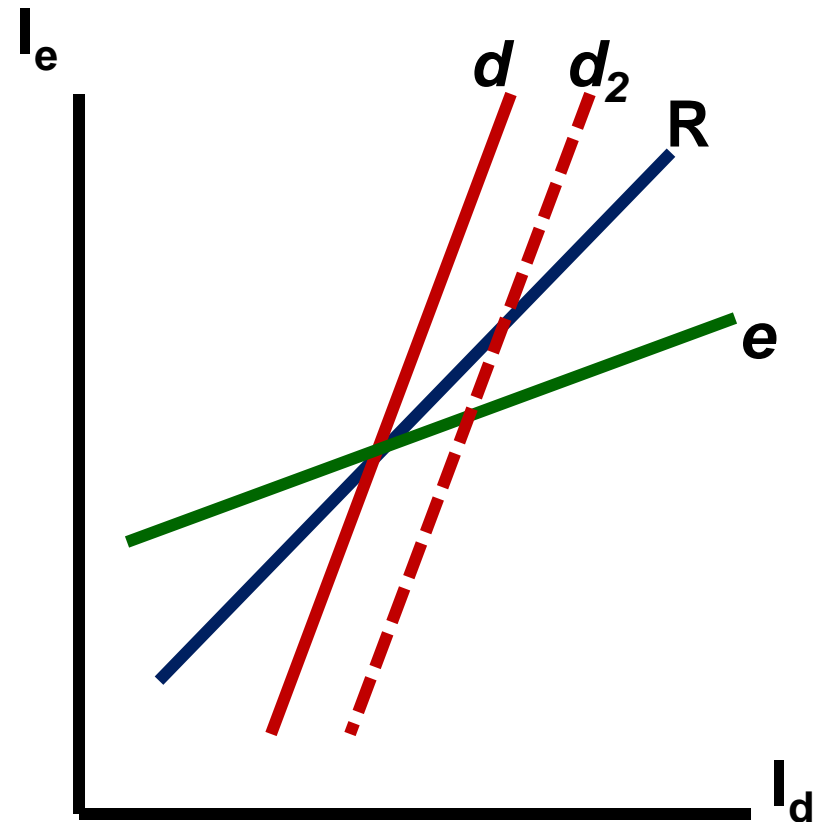
**The more there is inherent resource wealth, the higher the returns to lobbying, the greater the lobbying, and the greater the resulting policy distortions.**

# Rent-seeking-induced inefficiency: Public choice framework

2 latent groups within the lagging sector:

- Proponent: Domestic car producers ( $d$ )
- Opponent: Exportable electronics ( $e$ )

- Imported cars becomes cheaper after the boom.
- $d$  increases their investment in political influence.
- $e$  gets a double whammy, one from the boom and one from the tariff.



Protection formation function:  
Line R shows the combination of  $I_d$  and  $I_e$  that keeps protection constant

$$R = S(I_e, I_d, z); \frac{\partial R}{\partial I_d} > 0, \frac{\partial R}{\partial I_e} < 0$$

# Family resemblance of diverse curses

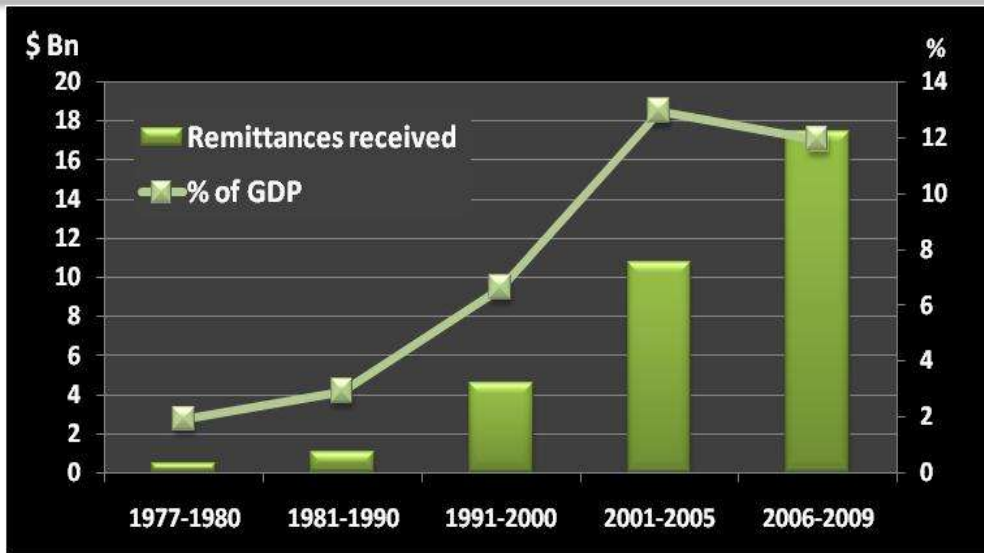
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- **Tourism**: Copeland (1991), Palma (2008)
- **Foreign aid**: Bautista (1988), Rajan and Subramanian (2006)
- **External Grants** (for Greenland from Denmark): Paldam (1997)
- **Export of financial services** in Switzerland, Luxembourg, and Hong Kong: Palma (2008)

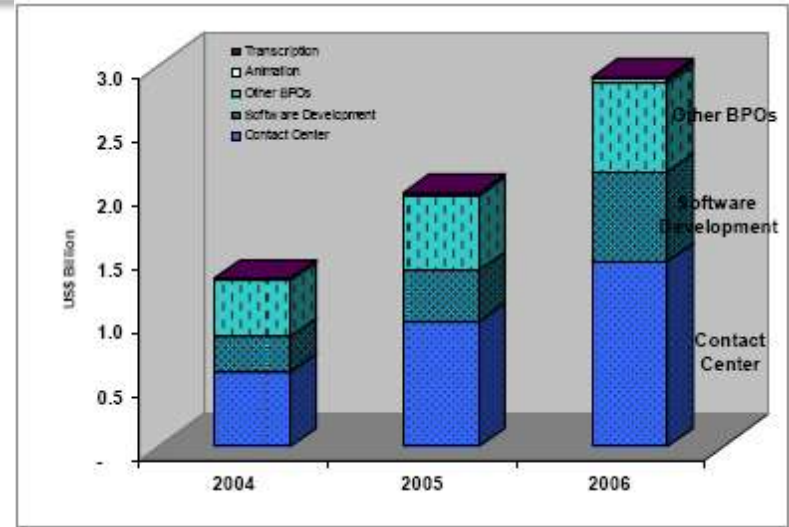
All come bearing foreign exchange gifts.



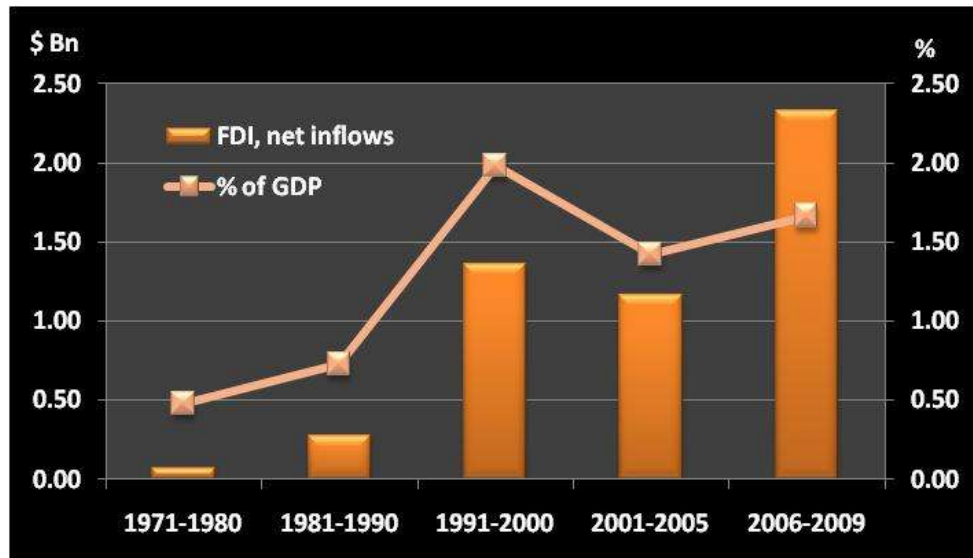
# Phils: All that curses is not gold



Remittances



Export services (BPO)



FDI

- Military bases
- Foreign aid

# Resource Curse: Modern era

- **Remittances as foreign exchange gift  $\Rightarrow$  ERA**  
(Amuedo-Dorantes and Pozo 2004, Lartey et al. 2009, Acosta et al. 2009).
  - ERA tends to squeeze manufactured exports
  - Low growth in manufactured exports at 1.4% (ADB, 2007)
- **Growth externalities in booming sector may be less than those lost from **manufactured**  $\Rightarrow$  **econ dev is adversely affected****

Manufacturing sector increases lobbying for protection both to compensate for ERA losses and because export growth increases demand for importables.

# Magnet for the iron triangle

**Induces complacency and tolerance among the people leading to more rent-seeking and solidifying bad institutions.**

- **Aid and budget deficit in the 70's-80's helped cause "crony capitalism." Potential rents beget more rent-seeking.**
- **Misguided transport regulations, especially shipping between major islands exacerbate geographical fragmentation (ADB, 2007, Balisacan et al., 2008)**
- **Large conglomerates deter entry through political connections to support higher prices.**
- **White elephants: cultural centers, BNPP, cement industries**
- **NFA rice monopoly; exemption of the sugar industry from land reform and WTO provisions**

# Concluding remark

- **Generalized resource curse *could* be an important reason for bad policies, bad institutions, and slower growth in Philippines.**
- **Turning the curse into blessing.**
  - **Booming sector may also stimulate growth depending on growth externalities.**
    - **Government needs to **facilitate** (e.g. investment coordination)**
    - **Invest in productivity enhancing activities (e.g. remittances going to education expenditure)**

**Cám o'n!**  
**Mahalo!**

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# Protection of the lagging sector

- Collier and Venable 2008: regression with a sample of 40 countries for which there is data on resource revenues (accruing to government) as opposed to resource exports. **Countries tend to set higher tariffs**

Table 1: Explaining the Tariff Rate

	Weighted average tariff rate	Weighted average tariff rate	Weighted average tariff rate
Resource exports % GDP	0.0086 (0.04)	-0.0516 (0.058)	
Resource revenues % GDP			0.177 (0.079)
Aid % GDP	0.129 (0.085)	0.023 (0.105)	-0.116 (0.246)
GDP per capita	-0.0003 (0.00015)	-0.0035 (0.0018)	-0.00056 (0.00021)
Constant	9.67 (1.08)	13.35 (2.27)	8.85 (1.72)
N	131	76	40
Adjusted R <sup>2</sup>	0.05	0.05	0.13

Notes: Data used are mean values of annual data from 2000 – 2005, with the exception of tariff rates, which are annual values for specific years between 2000 and 2005.

“Most likely explanation for this relationship is that as the foreign exchange inflows from resource exports appreciate the real exchange rate this squeezes the profitability of the firms in the import substitute sector and they successfully lobby for tariff protection.”

# Rent-seeking models

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- **Becker Rent-seeking (gov't is passive black box)** – new income leads to  $\uparrow$  rent-seeking, which  $\downarrow$  net increase in society's income
  - More agents engage in rent seeking
  - Competition for rents dissipates rents, possibly even greater than 1.
- **Political economy (active gov't, iron triangle)**
  - Patronage
  - Short time horizon and large public sectors (over extraction of the resource and overexpansion of the public sector)

# On the other hand...

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- **Get rid of these “blessings?”**
  - **Wouldn’t ban mining a new gold discovery since the negatives need not outweigh the positives.**
- **FDIs and BPOs may also generate growth externalities (albeit lesser degree than manufactured exports)**
  - **Deregulation of banking industry may have generated some innovations, spillover effects, and LBD**
  - **BPO to KPO like India**
- **OFWs and professionals may return if and when the economy becomes sufficiently dynamic.**



# Rents to be had from remittances?

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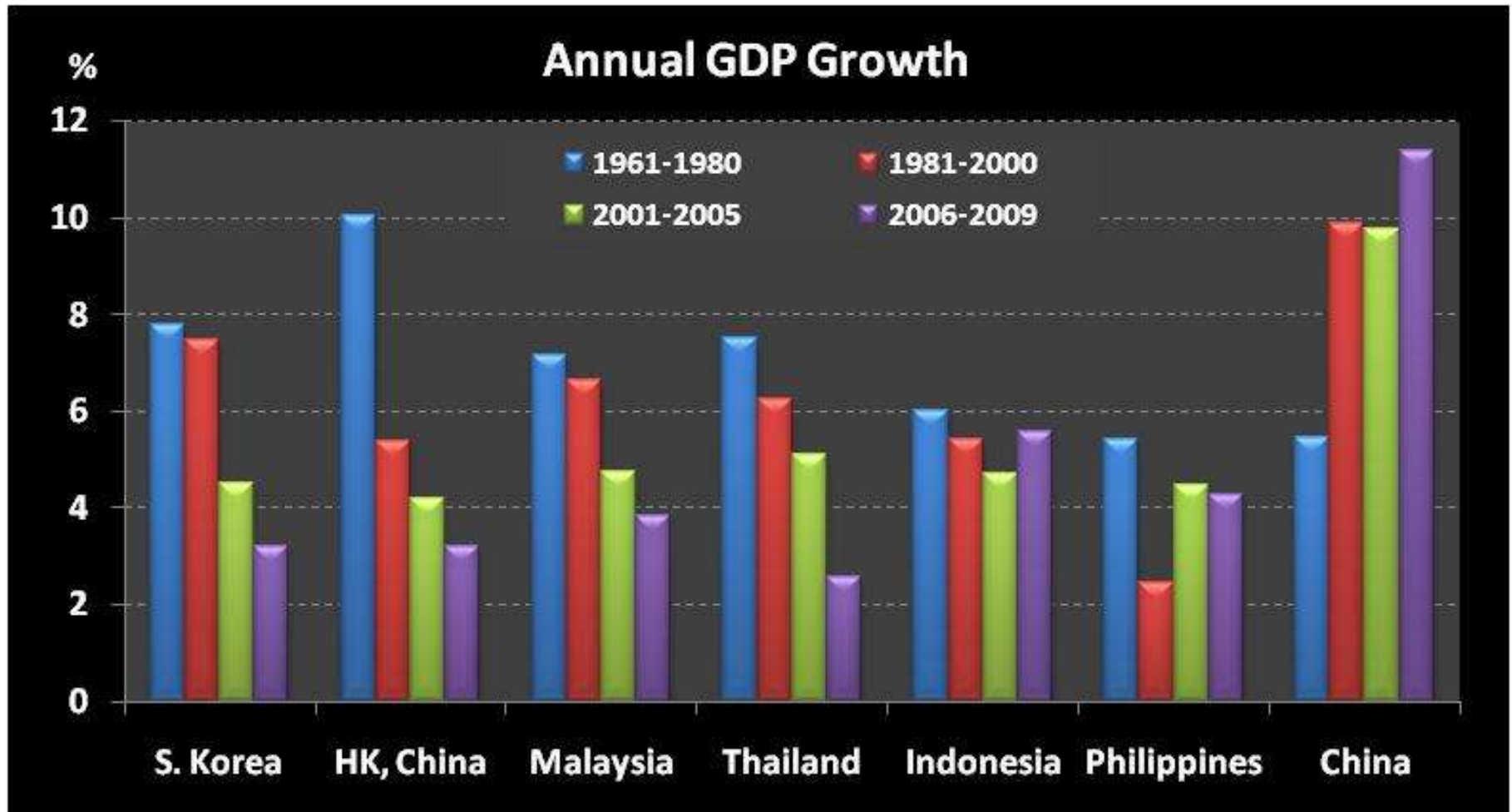
- ❑ Rents from remittances are privately transferred to households. Appropriable via transaction fees but supply is presumably elastic and fees are small.
- ❑ It is also widely distributed both geographically and across income groups.
- ❑ Thus, direct rent-seeking opportunities are small.

# Philippines: A development puzzle

- Laggard among flying geese (1960s and 1970s)
- East Asia's stray cat among tigers (Vos and Yap 1996)
- Soft state – hostage by rent seekers and can't invest in appropriate infrastructure (Fabella 2000)
- Why Philippines? (Barro and Sala-i-Martin 2004, Acemoglu et al. 2006, Lucas 1993)

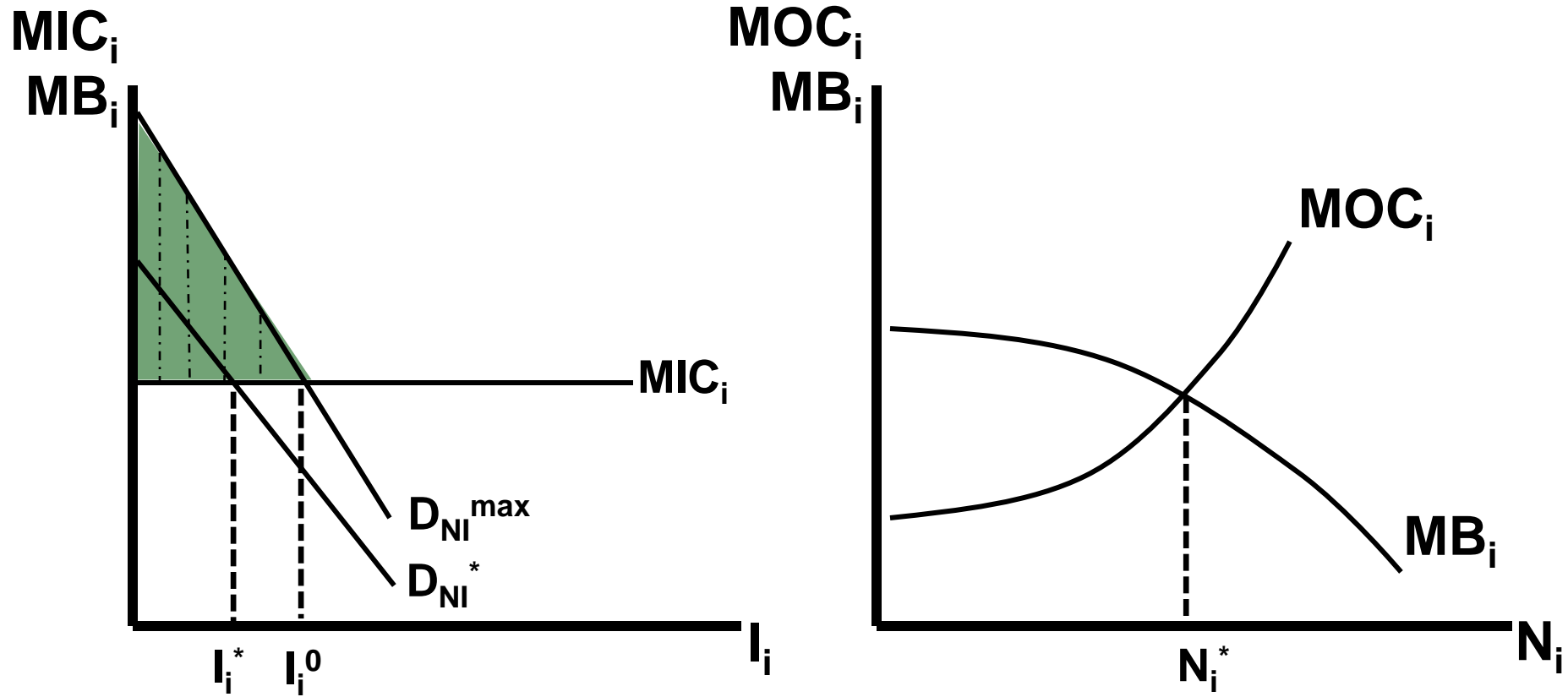
The PHILIPPINES

# Philippine growth lagged during East Asian boom, esp 1961-2000



Recent developments are reminiscent of the capital-intensive “finishing stage” industrialization.

# Collective provision of Investment in political influence



Adapted from Balisacan and Roumasset, 1989

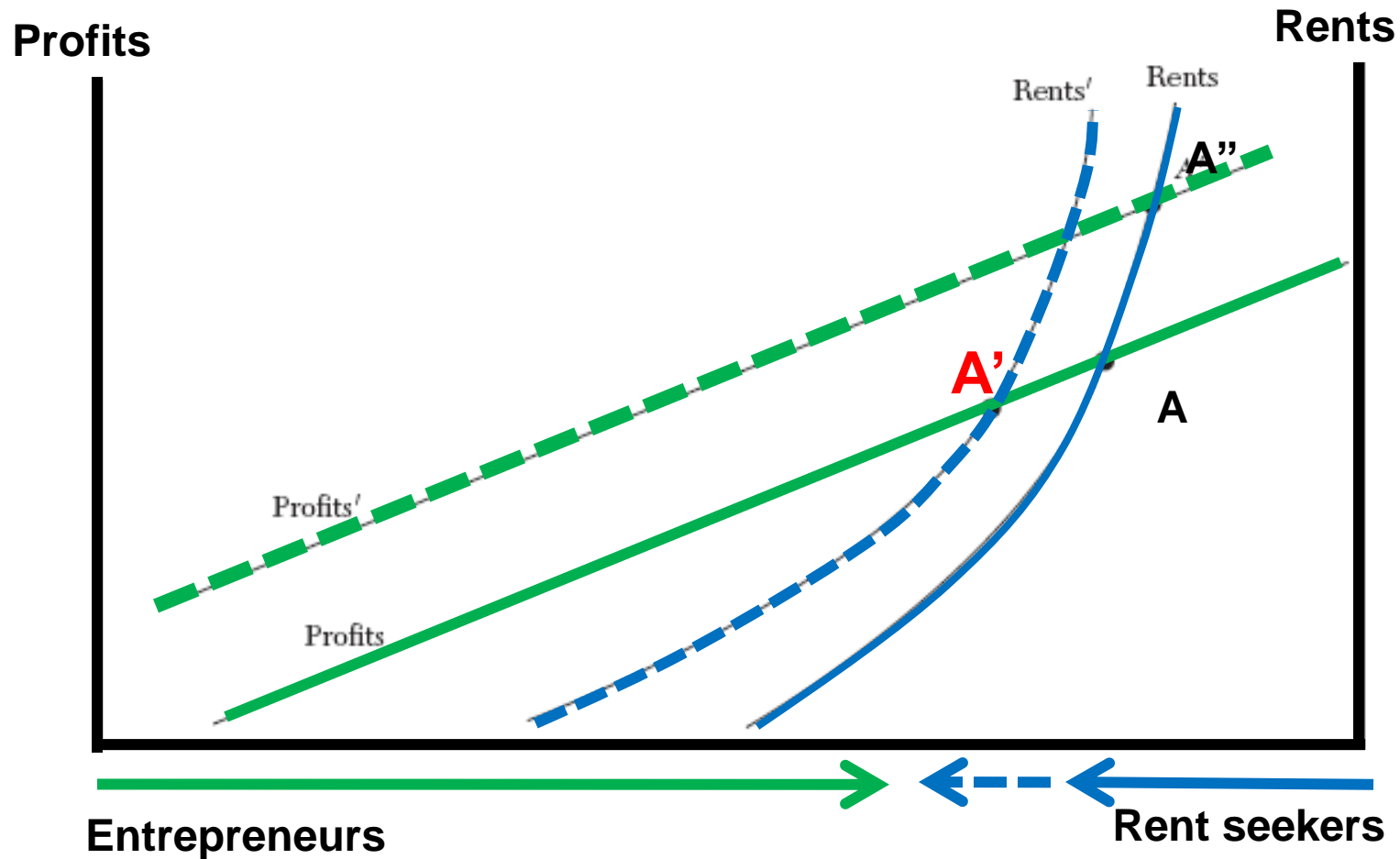




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# EXTRA SLIDES

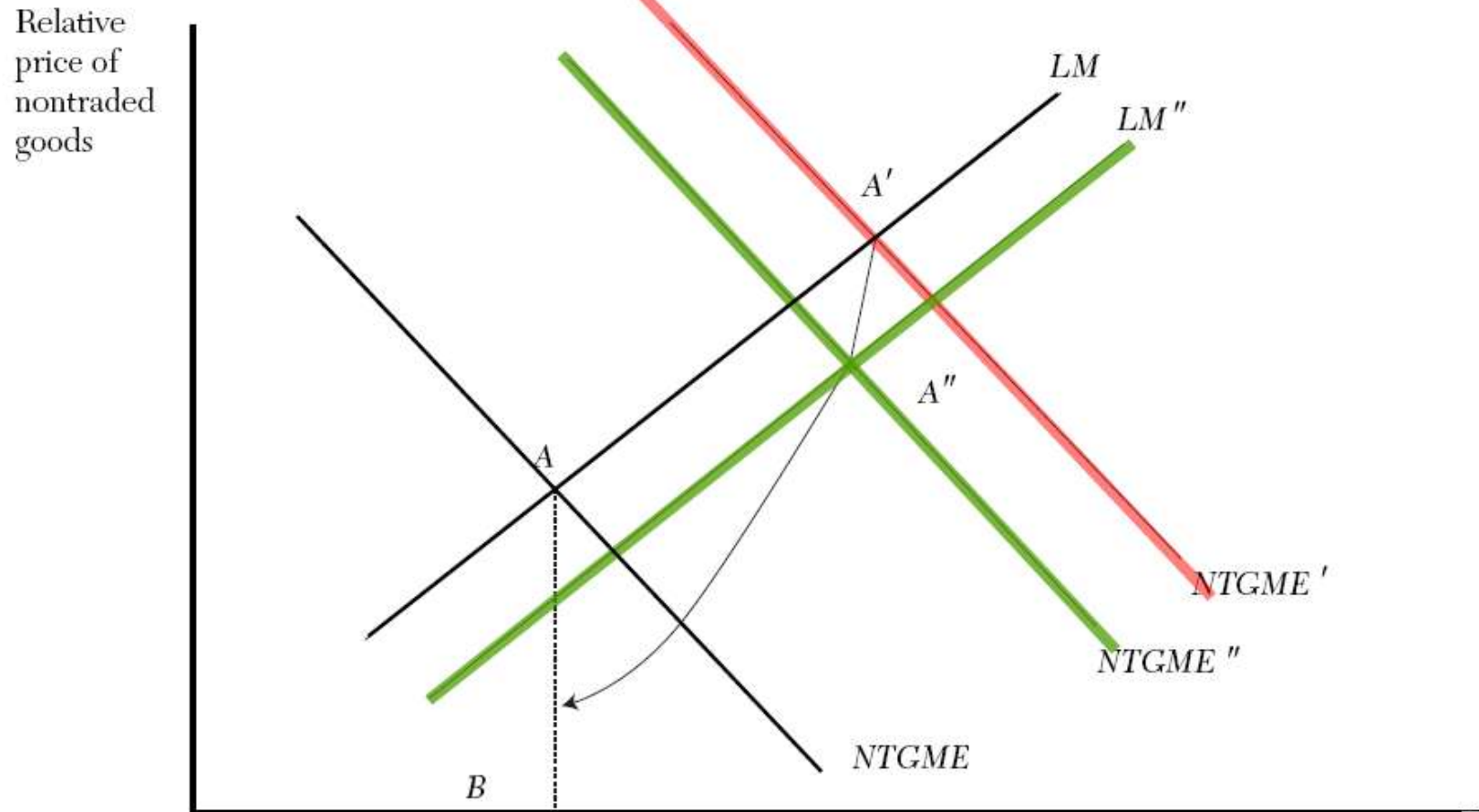
# More rents to be had, more rent-seekers



**Weak institutions begets more rent-seeking.**



# Dutch Disease Mechanics: Appreciation of the Real Exchange Rate



# **Rent-seeking induce inefficiencies**

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- **Large conglomerates were able to raise prices and deter entry through political connections.**
- **White elephants: cultural centers, BNPP, cement industries**
- **NFA rice monopoly; exemption of the sugar industry from land reform and WTO provisions, government offices being controlled by political appointees**
- **Misguided transport regulations, especially shipping (ADB, 2007, Balisacan et al., 2008)**
- ❖ **Lowest score on control of corruption and political stability since 1996 and on rule-of-law since 2002 (ADB, 2007)**

# **If there's something to take, somebody will take it.**

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- **Industrialists adversely impacted by the appreciation of the real exchange rate increasing their lobbying effort for tariff and non-tariff protection (Corden 1984).**
- **Breeds bad institutions increasing the inefficiency in the system.**
- **Induces complacency and tolerance among the people leading to more rent-seeking and solidifying bad institutions (Sachs and Warner 1995).**

No explicit model!

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- **Rent-seeking middlemen**

**The multi-billion dollar remittance industry has sparked cutthroat competition among local banks and a proliferation of thousands of non-banks or "informal channels" such as door-to-door enterprises, couriers and other "fly-by-night" remittance handlers. Even those fronting as Internet cafes, money changers, pawnshops, cargo forwarders and post offices often also operate as "remittance centers" on the side.**

**Mostly unlicensed by the central bank, these underground financial conduits thrive because of the high charges banks impose on fund transfers.**

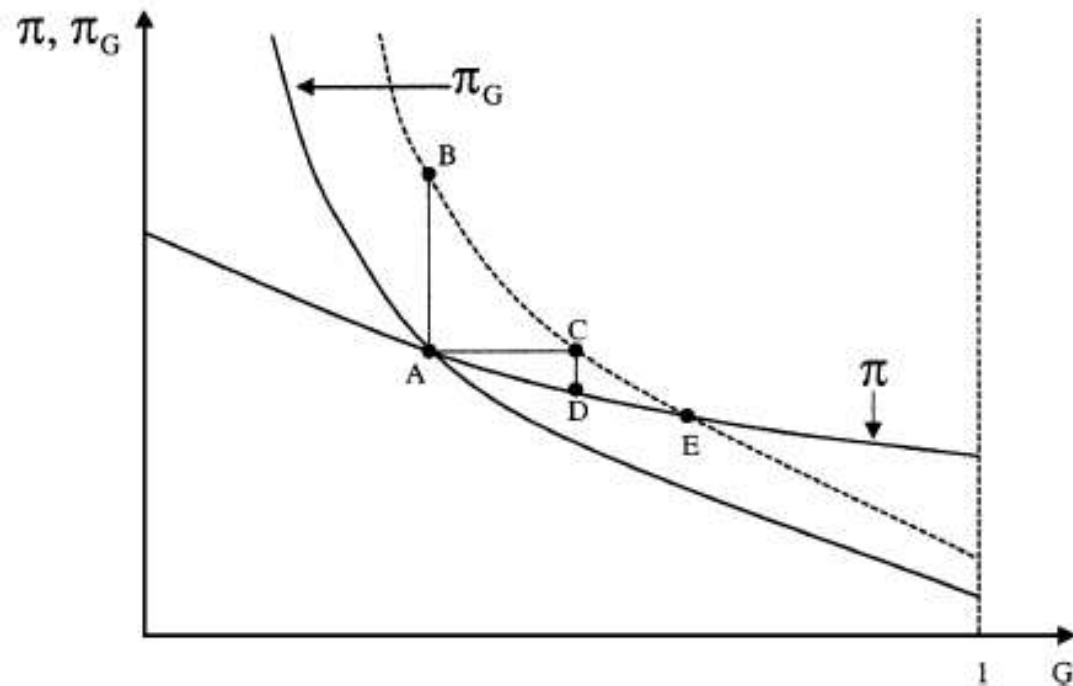
**The Trade Union Congress of the Philippines (TUCP), a labor group, cited a [World Bank](#) study in 2009 which found that Filipinos pay charges of between \$6.93 and \$19.05 to remit just \$200.**

# Literature on Political economy and Rent-seeking

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- **Rent-seeking** - not a competition for rents but the resources expend on getting a larger share of the rents.
  - **Determinants:** initial quality of institutions, initial level of rent-seeking, ethnic fractionalization.
- **Patronage** – strengthening political support by awarding contracts and favors
  - **Depends on institutions**

# This is a note. See also note section



$$\pi = (\tau - t)y - F$$

$$\pi_G = \frac{\pi^T}{G}$$

$$\pi^T = t(1 - G)y + R$$

Equal rents for each  
rent-seeker

$\pi = \pi_G$       Equilibrium

Source: Torvik 2002

- “it is easily seen that with a higher  $R$  (windfall income; also rents), it becomes more profitable to be a rent seeker at all levels of rent seeking. The profit curve for rent seeking thus, shifts up to the dotted curve in Fig. 1. The new equilibrium in point  $E$  involves fewer modern firms and more rent seekers, and lower profits for each entrepreneur.”

# See also next section

$$R = (f_E + g_M)R$$

- $f$  is the relative shares in the rent, which is a function of investment in political influence

$$f_E = f(I_E, I_M, z), \quad \frac{\partial f}{\partial I_E} > 0, \frac{\partial f}{\partial I_M} < 0$$

$$f_M = g(I_E, I_M, z), \quad \frac{\partial g}{\partial I_E} < 0, \frac{\partial g}{\partial I_M} > 0$$

$$f_E + f_M = 1$$

- Benefit function:

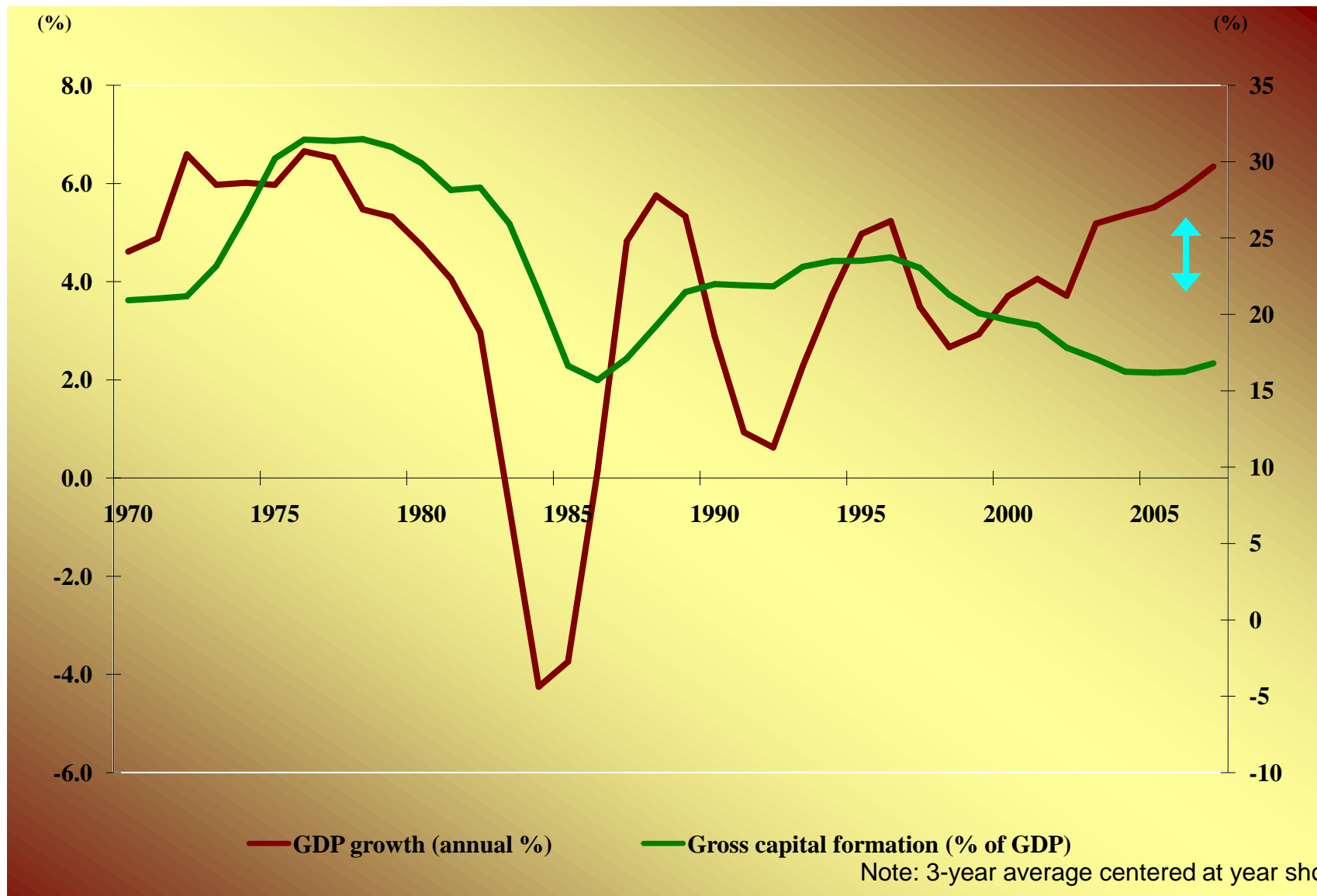
$$B_i = B_i(f_i, N_i, x_i) \quad i = E, M$$

- Cost function

$$C_i = V_i + G_i$$

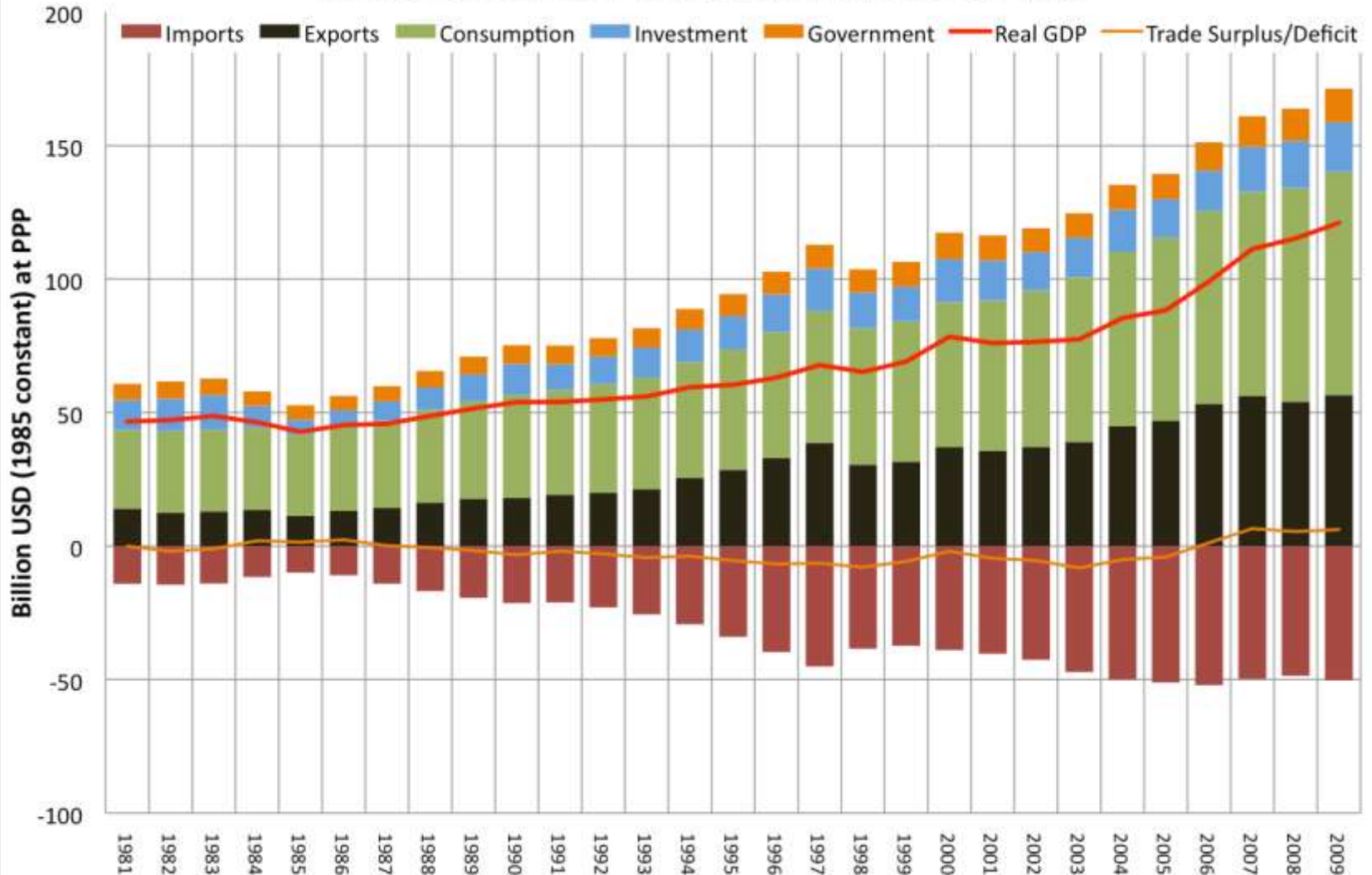
Cost = opportunity costs and organizational costs

# Economy is growing but investments is declining

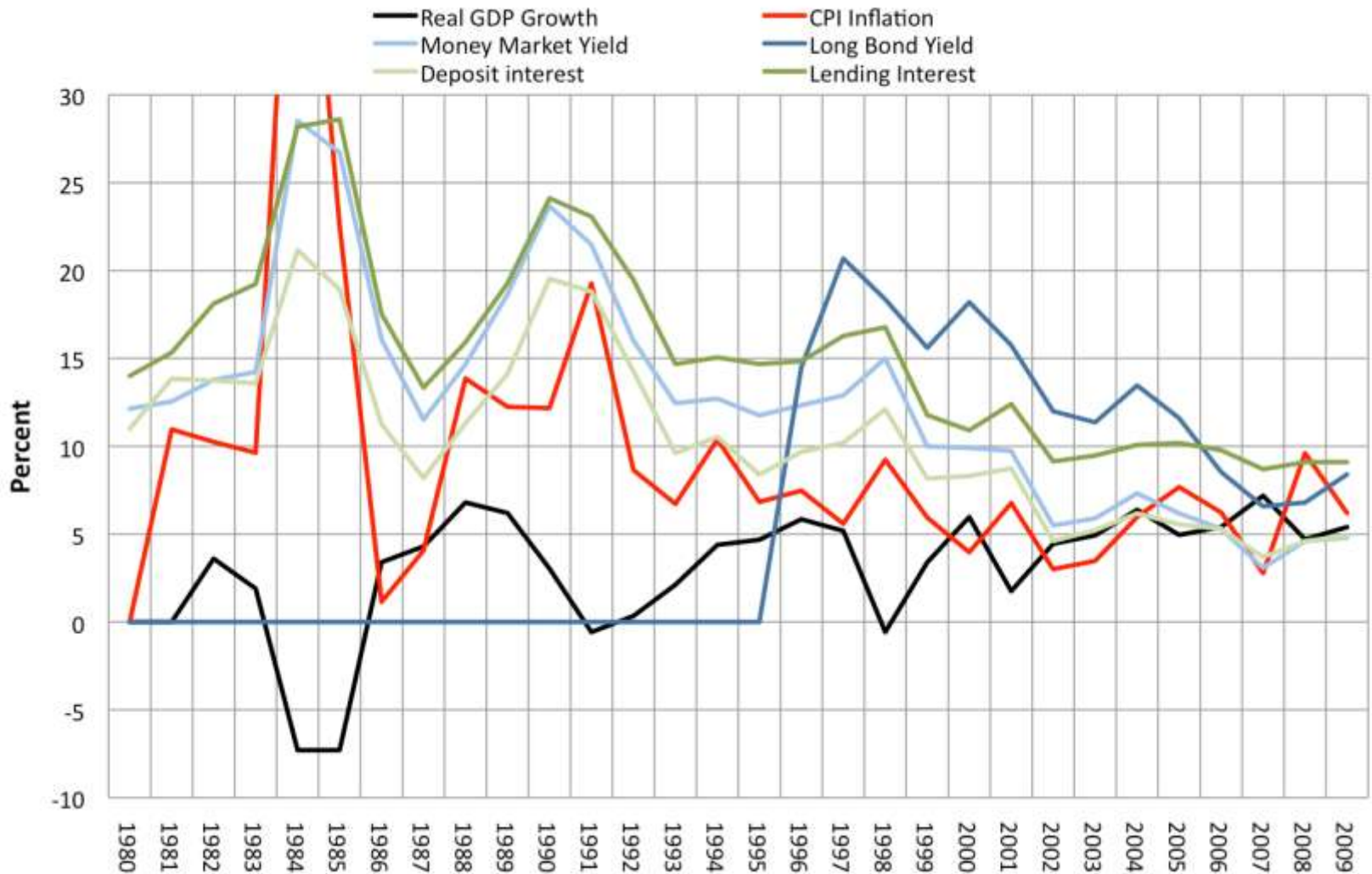




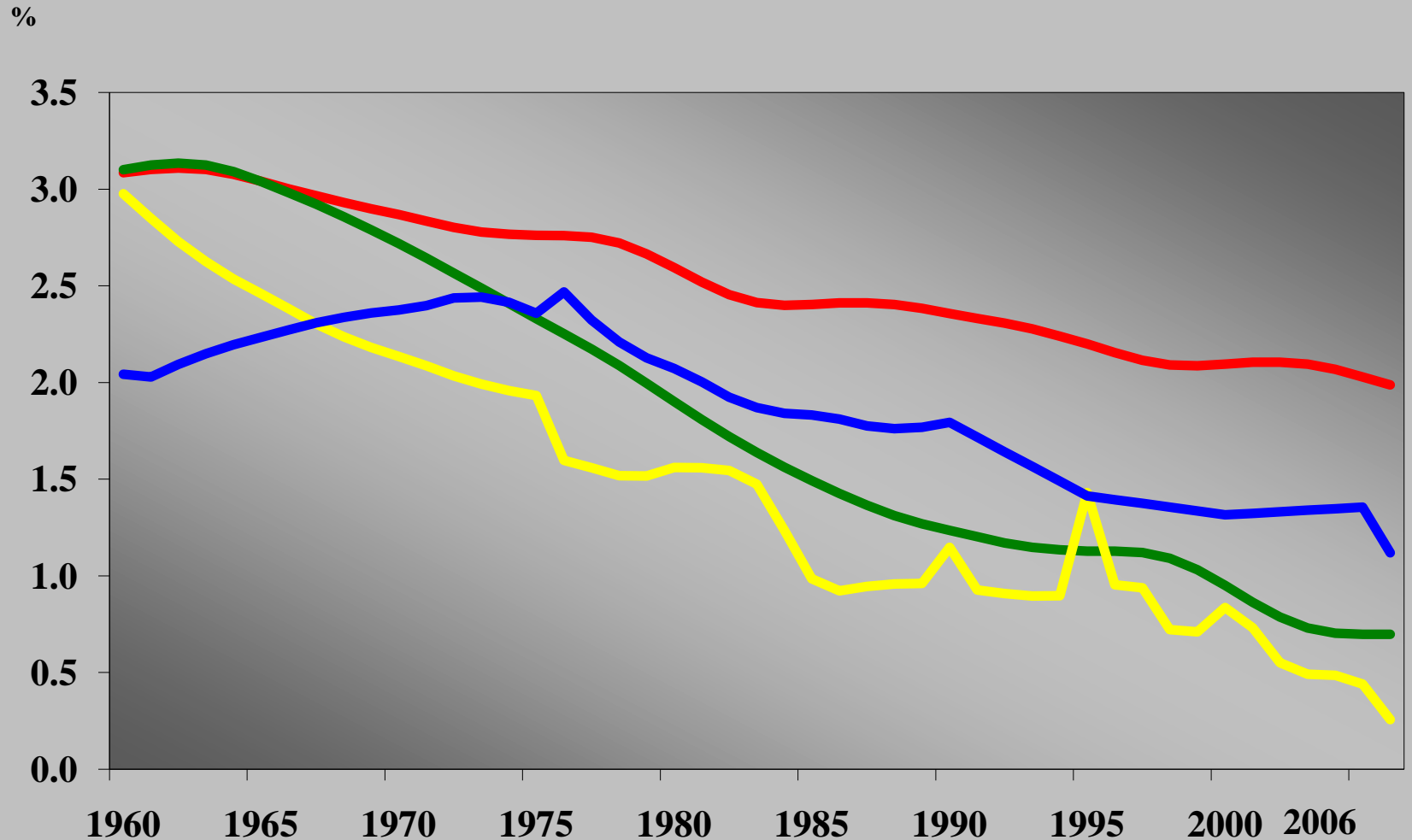
## Philippine Real GDP and Components: 1981-2009



## Philippine GDP Growth , Inflation, and Interest Rates: 1980-2009



# High Population Growth



Pop + low investments  $\Rightarrow$  under-building of human resources' capacity, high unemployment, and brain drain problems

Philippines

Thailand

South Korea

Indonesia

# Weak response of poverty to growth

<b>Countries</b>	<b>%</b>
<b>China</b>	<b>2.9</b>
<b>Thailand</b>	<b>3.5</b>
<b>Indonesia</b>	<b>3.0</b>
<b>Philippines</b>	<b>2.2</b>

Figures are “growth elasticities of poverty” of growth reported in Cline, W.R., *Trade Policy and Global Poverty*, Washington D.C.:Institute of International Economics, 2004.

# Fragmentation

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- **Geographic fragmentation** – exacerbated by inadequate transportation infrastructure and misguided transport regulations, especially shipping (ADB, 2007, Balisacan et al., 2008)
- **Economic fragmentation** – protection afforded to agriculture, services and some manufacturing (e.g. steel and some petrochemicals).
- **Political fragmentation** – bureaucratic red tape increase the cost of doing business. Politically influential entrepreneurs are able obtain exemptions or easy passage through the barriers.

# Objective

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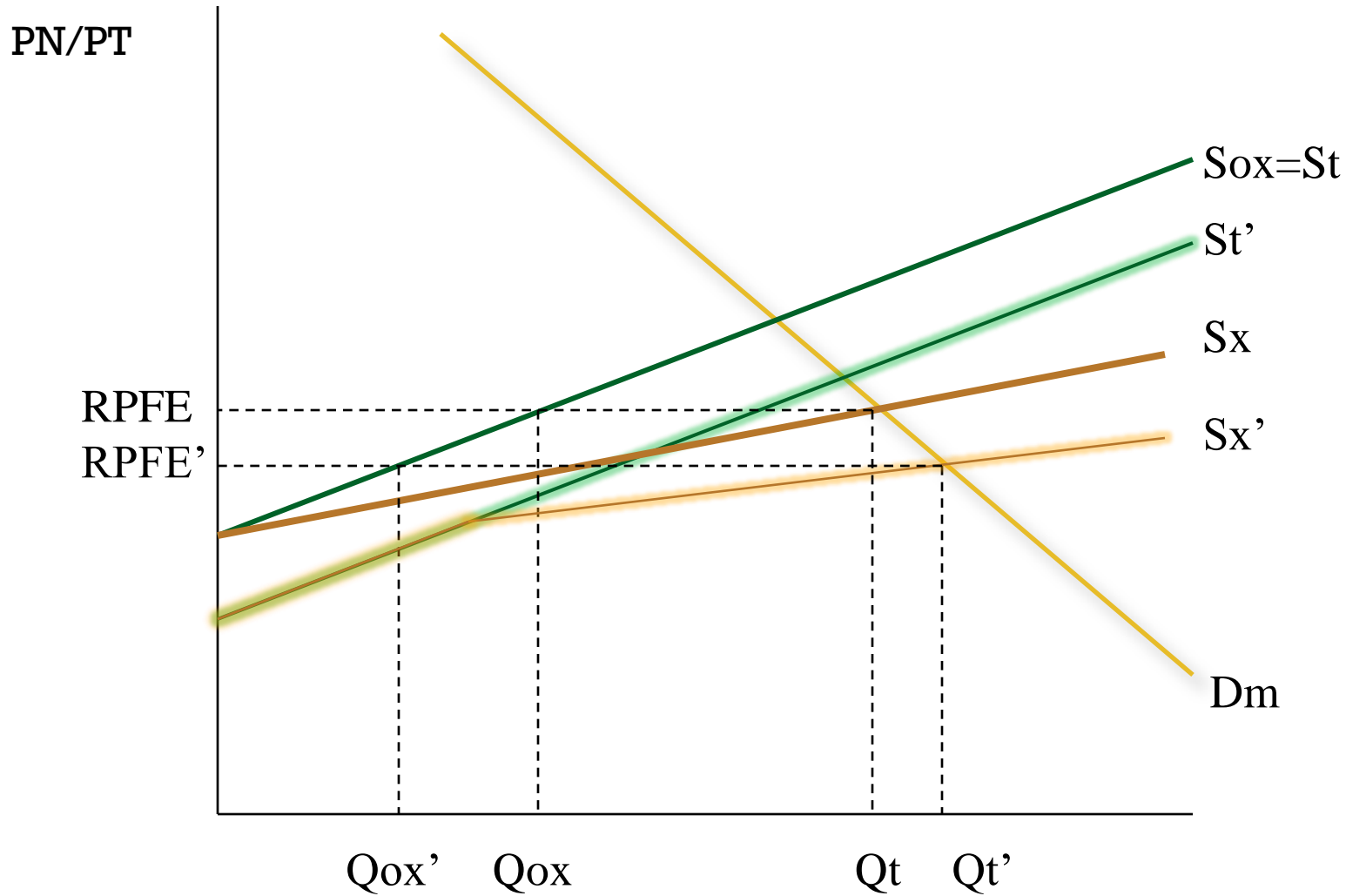
- ❑ **To contribute to the theory of resource curse by developing a model of rent-seeking-induced inefficiency using the framework of public choice of economic policy**
- ❑ **To elucidates the nature, consequences, and causes of rent-seeking-induced inefficiency with particular application in the Philippines**

# Research Strategy

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- **Document indicators of inefficiencies**
  - **Why DD can cause inefficiency?**
- **Expand the theory of DD beyond natural resource and complete the theory by develop a model of rent-seeking-induced inefficiency building on Becker (1983) public choice theory on the growth of agricultural protection.**
- **Assess the consistency of the model and the evidence**

# Tourism Boom Increases Imports & Squeezes out Other Exports





# Measures Resource Abundance and Dependence

<b>SW 1997:</b> <b>RD as proxy for RA</b>	<b>TPX/GDP</b> <b>SNR/GDP</b> <b>PXI70</b>	<b>Primary X (agri, fuels, minerals) to GDP</b> <b>Minerals to GDP</b> <b>Primary X to total X in 1970</b>
<b>BB 2008:</b> <b>RD</b>	<b>TPX/GDP</b> <b>SNR/GDP</b>	
<b>RA</b>	<b>NC</b> <b>Subs</b>	<b>Natural capital per capita</b> <b>Subsoil per capita</b> <b>Source: WB 1997</b>
<b>M et al 2009</b> <b>RD</b>	<b>NC/TC</b>	<b>Natural capital to the sum of physical, human and natural capita</b>
<b>RA</b>	<b>NC</b> <b>Subsoil</b>	<b>Natural capital per capita</b> <b>Subsoil per capita</b> <b>Same source as BB</b>

Why is this a better measure?