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Curse or mismanagement?

PROFESSOR T.K. JAYARAMAN

When anything goes wrong, there are always two explanations: blame it on bad luck or poor judgment.

When an economy does badly in terms of poor rates of growth or inflation, economists put the blame on shocks: external or internal.

When an economy does well in terms of high rates of growth or low inflation, economists attribute the performance to positive shocks: external or internal.

The external shocks, either negative or positive, are beyond the control of any government. The negative external shocks include steep oil price or recession. Increase in international oil price leads to imported inflation, as oil is the real lubricant of the economy. Recession overseas reduces employment and incomes, resulting in less tourist arrivals for countries depending on tourism and less remittances.

Internal shocks are also of two kinds: negative and positive. Negative domestic shocks include natural disasters, destroying productive base. Positive shocks include discovery of mineral resources which add to productive resources or improvements in productivity of labour through education and training. These positive shocks are due to good policies of government, contributing to an investor friendly environment.

Fall in commodity prices

What if an economy with a rich endowment of mineral resources does badly for last two years, since 2014?

Could it blame the fall in oil price: from US$100 a barrel in 2014 to US$45 a barrel in 2016?

In fact, such falls in commodity prices and decline in export earnings are not new. They happen to be part of cyclical disturbances. Good times being followed by bad times have been given a name as well: resource curse!

A mild label will be Dutch Disease. The term disease indicates possibility of cure.

The resource curse is a stronger description of a possible no-return to normalcy situation. The term Dutch disease has its origin from the Dutch economic crisis of the 1960s following the discovery of North Sea natural gas. As exports of the newly discovered resource brings a windfall in gains, value of the domestic currency increases. This appreciation of domestic currency hurts the competitiveness of traditional exports. Their decline leads to closure of the traditional export industries, resulting in unemployment and fall in incomes. The appreciation of domestic currency also leads to increase in imports of cheap goods from overseas which would lead to killing of domestic industries which would shift to other countries. This process of de-industrialization also pauperizes the nation. Thus, a discovery of rich resource, a blessing initially, can turn out to be an ultimate curse.

History has some lessons: in 2009, United Arab Emirates hade huge increase in oil revenue. The windfall profits went into the property sector, which actually led to a boom but only to get busted soon. On the other hand, Saudi Arabia which went through an oil boom phase in 2010 avoided the bust by restricting lending to housing sector.

If lessons are learned and appropriate policies are formulated and implemented vigorously, the Dutch disease is not only curable but also preventable in the future.

Papua New Guinea

Recent discovery of liquefied natural gas (LNG) and substantial foreign investment in LNG project enabled PNG, which is already a mineral resource rich country, to record high rates of growth during the last seven years. The growth rates in percent were: 7.6 in 2010; 11.3 in 2011; 7.7 in 2012; 5.5 in 2013; and 8.5 in 2014. As world commodity prices began to decline, PNG earned less. Its growth in 2015 was still high: 9 percent.

PNG has a flexible exchange rate regime. Inflows of foreign exchange following high commodity prices during 2010-2012 and LNG project construction contributed to appreciation of the domestic currency *kina*. As the boom was to be followed by a bust, following a similar episode in PNG more than a decade ago (known as *Lost Decade* in the nation's history, fiscal discipline slackened since 2012.

As government spending rose, kina began to depreciate in 2013. Higher spending also raised the public debt above the mandated ceiling of 35 percent of GDP. Due to falling commodity prices in 2014 and the completion of LNG project reducing the FDI inflows, the kina began to slide down. The central bank intervened to stop the decline by buying kina by selling foreign exchange, leading to decrease in reserves. There was already a big backlog of applications for foreign exchange by importers, foreign exchange crisis ensued. PNG may seek a loan from World Bank for US$ 300 million.

That is how the history gets repeated, if we do not learn lessons.

The April IMF forecasts for PNG for 2016 and 2017 are optimistic: Lower budget and current account deficits, inflation of not more than 5 percent. There is a big : if the planned cuts in public expenditures are done.

However, there is a loud and clear message, valid for all countries including PNG with a flexible exchange rate.

"Foreign exchange intervention should not be used to resist currency movements reflecting changing fundamentals or as a substitute for macroeconomic policy adjustments".

Venezuela

IMF is not so optimistic on Venezuela.

Venezuela (population 30 million, GDP per capita: US$16,000), which has the largest oil reserves in the world, is in trouble.

With no export diversification, the country depends only on oil exports, with more than 95 percent of exports being oil. Following a steep decline in oil price, the economy has plunged, with decrease in export earnings. It is beyond repair. The economy shrank by 10 percent in 2015 and expected to shrink further by 8 percent in 2016.

Being a socialistic country, it has squandered all its export revenues on populist welfare measures.

The result is today it has no resources to meet emergencies, including life saving drugs from overseas. With shrinking export earnings from oil, shortages of foreign exchange have forced multinational companies to shut as they cannot import raw materials to manufacture consumer goods including toilet paper. The government is now the sole primary importer.

Shortages of food, milk, toilet paper, all consumer goods and medicines have pushed the inflation to 275 percent in 2015. The IMF forecast for 2016 is 720 percent.

The central bank has added its own to the cup of misery: massive printing of the domestic currency, the *bolivar*. The value of the *bolivar* against the US dollar has plummeted.

The official exchange rate is 10 bolivars per US dollar, which has no meaning. It is the black market that works, where you pay 800 bolivars for getting one US dollar. That was in January 2016, up from less than 200 bolivars a year before. This May, it is 1100 bolivars.

To top it all, no one wants to interfere. Reason, the President Maduro is a despot. He has created the usual smoke screen of “a planned invasion by foreigners against his country” for hiding his faults. He announced he would conduct military exercises soon.

Professor Ricardo Hausmann, a Venezuelan and director of the Harvard Center for International Development says Venezuela's problems are a consequence of the craziest economic policy ever in a country or in the world. Its external debt servicing obligations this year would be around US$ 10.5 billion. That would be a problem

Professor Hausmann adds:

“It’s a country that has gone through its longest and highest oil boom in its history, and ended that period over-indebted, with a destroyed productive capacity, and now it cannot face the reduction in the price of oil.”

Now you can decide: Is it a resource curse or mismanagement?

Professor Jayaraman teaches at FNU, Nasinu campus. His website is: www.tkjayaraman.com