

# The Political Economy of Resource Dependence

## Russia's Addiction

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# Introduction:

- Presence of resource rents obscures measurement of economic magnitudes.

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- Presence of resource rents obscures measurement of economic magnitudes.
  - This is not a (big) problem in market economies The rent flows represent income to the owners of assets.

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  - In such economies non-transparent flows is the norm. These mask the true flows of economic activity in the economy

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- In SU prices were set so that industry looked larger and raw materials and services added less value than actually was the case (Ericson, 1999).

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  - In such economies non-transparent flows is the norm. These mask the true flows of economic activity in the economy
- In SU prices were set so that industry looked larger and raw materials and services added less value than actually was the case (Ericson, 1999).
  - $\implies$  price liberalization led to a larger *apparent* contraction in manufacturing output than in actual value added. Circus mirror effect.

# Non-Transparency

- Non transparency of wealth transfers designed to maintain legitimacy for activities that would not survive markets

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- Non transparency of wealth transfers designed to maintain legitimacy for activities that would not survive markets
- Informal flows obscure true dimensions of the economy – they can make the oil sector look smaller than it is, for example, in Russia

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- Systems of measurement have an implicit institutional component.
  - We assume that activities are undertaken because they are economically advantageous. Think of how we value government services, despite our cynical view of them. But in some economies this assumption is too far stretched. Russia is our example.

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# Measurement, efficiency and power

- Measurement apparatus is based on notion of efficiency and opportunity cost

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- But Soviet system defied this – economic decisions not based on opportunity cost

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- Russia inherited this system, and it uses the windfall from oil and gas to reinforce it

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- Measurement is not neutral – it confers power through legitimacy
  - an industry that *appears* to be producing value added will not be shut down

# Importance of Resource Rents

- To understand Russia's political economy it is useful to focus on resource rents

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- To understand Russia's political economy it is useful to focus on resource rents
- Comprehensive view of the impact of resources on the economy

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  - focus is on oil and gas because of size and because they are easier to estimate

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- Comprehensive view of the impact of resources on the economy
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- Resource rents are huge in Russia

# Defining Resource Rents

- The value of current production less costs of production and transport

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# Defining Resource Rents

- The value of current production less costs of production and transport
- What is *potentially* available for distribution

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- Definition

$$R_t \equiv P_t Q_t - C_t \quad (1)$$

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- Actual costs differ from reported costs, so reported rent is

$$\begin{aligned} \hat{R} &= P_t Q_t - \hat{C}_t \\ &= P_t Q_t - C_t - \varepsilon_t. \end{aligned} \quad (2)$$

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- Rents are *much* bigger than after-tax profits:

$$P_t Q_t - C_t = \frac{\pi'_t}{1 - \tau - \tau'} + \rho Q_t + \varepsilon_t \quad (3)$$

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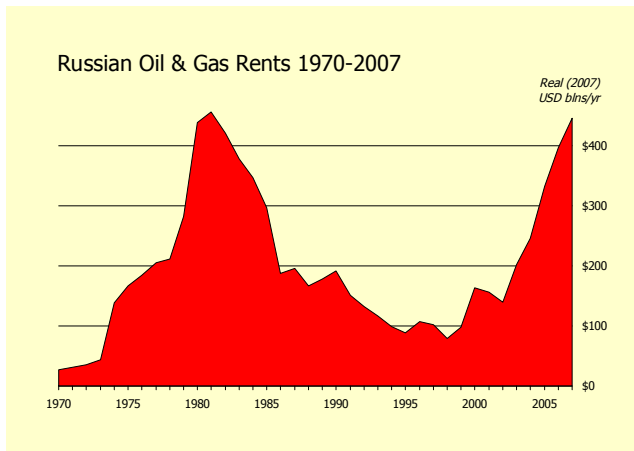
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$$P_t Q_t - C_t = \frac{\pi'_t}{1 - \tau - \tau'} + \rho Q_t + \varepsilon_t \quad (3)$$

- Key item → fluctuations in price of oil – estimate of rents is relatively invariant to cost estimates

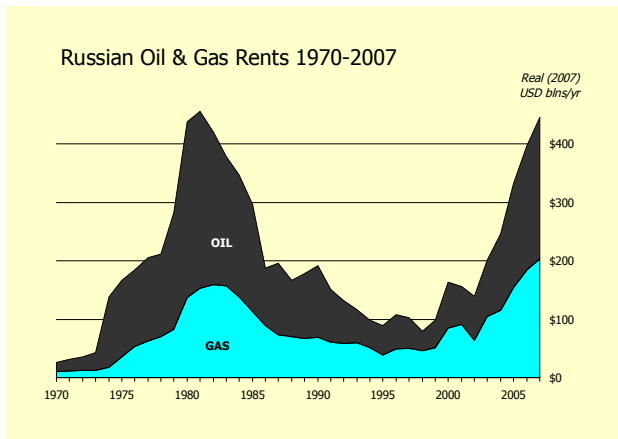
# Oil and Gas Rents 1970-2007

- Resource rents are huge



# Oil and Gas Rents 1970-2007

- Oil rents larger, gas rents more stable



# Iceberg

- Stabilization fund protects formal expenditures of budget, but is only a small share of rents.

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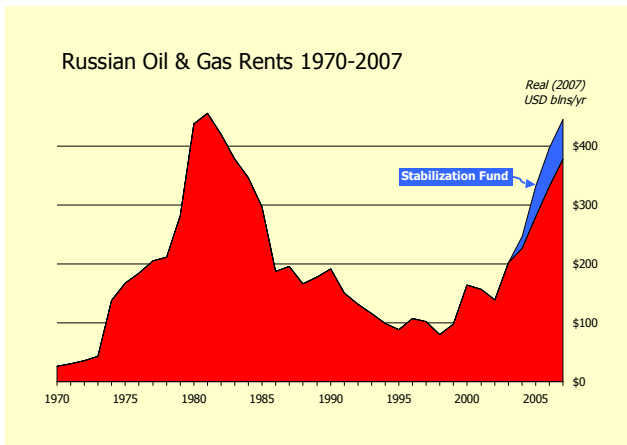
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# Rents and Leadership

- Variation in rents explains leadership success

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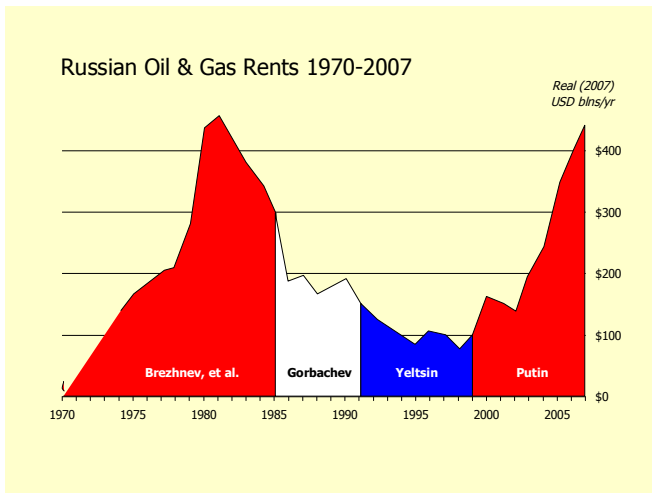
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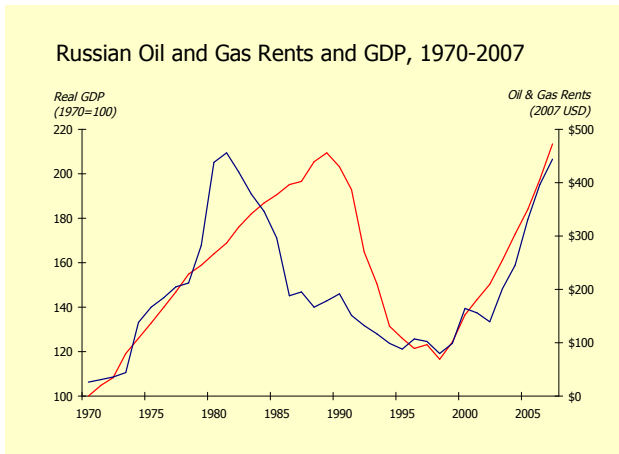
# Rents and Leadership

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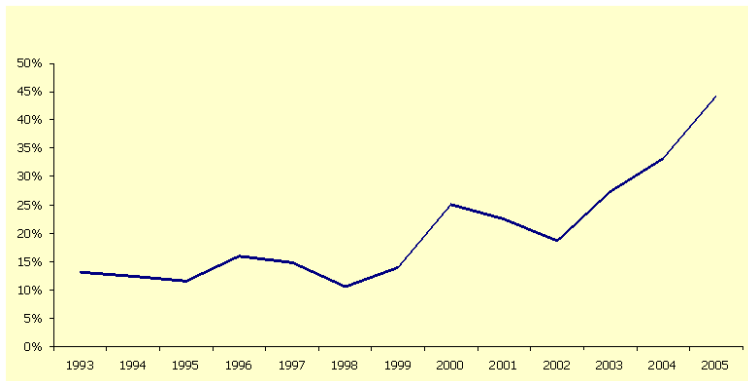
# Rents and Russian GDP

- Rent Fluctuations Crucial for GDP movements



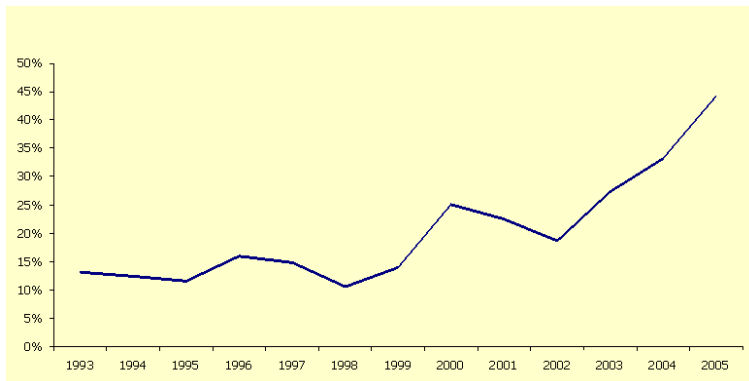
# Growing Importance of Rents

## ■ Share of Oil and Gas Rents in Russian GDP



# Growing Importance of Rents

## ■ Share of Oil and Gas Rents in Russian GDP



## ■ Much larger than value added share of this sector in GDP

# Components of rents

- Distribution of rent is the critical issue of Russia's political economy

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- Categories

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- Categories
  - Price subsidies, excess costs, formal taxes, informal taxes

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- excess costs
- informal categories of rent are the part of the iceberg below the surface

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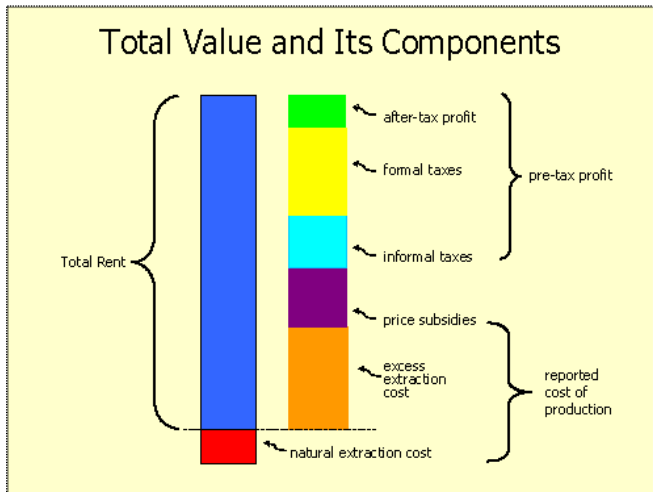
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# Some Implications

- Excess costs and informal payments raise costs and redistribute value

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- Excess costs and informal payments raise costs and redistribute value
- Oil and Gas appears to be 10% of GDP when it is much more

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- Relative price of investment (PPP) is exceptionally high because of excess costs

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- Excess costs and informal payments raise costs and redistribute value
- Oil and Gas appears to be 10% of GDP when it is much more
- Relative price of investment (PPP) is exceptionally high because of excess costs
- Share of investment in GDP measured at PPP is exceptionally low

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- When resource rents are large conventional measures may not provide a proper picture of economic activity

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- Importance of resource sector may be understated, important for cross-country comparisons

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- When resource rents are large conventional measures may not provide a proper picture of economic activity
- Importance of resource sector may be understated, important for cross-country comparisons
- Crucial to consider the institutional environment in order to understand how economic data is produced and represented
- Need better methods for measuring value added in resource dependent economies