

Dutch Disease and the Resource Curse: Final Effects for Newfoundland & Labrador

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Introduction

Anytime the subject of natural resource (petroleum) abundance and state performance arises, a discussion about Dutch Disease is bound to follow. And so it is with the topic of this paper. Except for current purposes, observations about Dutch Disease in the Canadian province of Newfoundland and Labrador (NL) constitute just the starting point of the discussion. To begin with, I shall offer the original definition of Dutch Disease, an economics concept much discussed yet distorted in every debate. After making some references on the reality of the theoretical construct and ground-level findings, I shall transition to the successor notion now widely referred as the “resource curse.” The resource curse is probably the better conceptual reference, certainly for those whose focus is state performance and not just economic aberrations. I arrive at a conceptual framework crafted from the resource curse literature identifying the rentier state, resource (management) ownership, economic growth, capital investment & economic development, and democratic accountability as key features. Empirical findings for NL based on secondary data are mixed both on the matter of Dutch Disease and the resource curse. While some successes have been achieved in NL, significant vulnerabilities remain.

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Dutch Disease

Dutch Disease is a conceptual formulation about resource booms and “deindustrialization” most fully worked out by economists Max Corden and Peter Neary in the early 1980s.³ Actually the term “Dutch Disease” was coined by the editors at the *Economist* in their November 26, 1977 issue when commenting about the ill-effects for The Netherlands’ economy. Large government revenue inflows and significant price changes emanating from huge natural gas discoveries in the North Sea were behind the disease. In simplest terms, Dutch Disease describes the negative effects of natural resource booms on manufacturing (and agricultural) export growth; booms that crowd out demand for “tradable” sector products, because labour is made more expensive and the value of the country’s currency rises with commodity revenues. In a kind of two-step process, commodity revenues drive up the price of labour, manufacturers suffer inordinately, pressure is placed on manufacturing profit margins and rising manufacturing costs are (in part) attributable to rising real exchange rates. With a higher value currency, manufactured export demand drops which leads to higher unemployment in the manufacturing sector. While higher national incomes from the resource sector grant higher demand for “endogenous” services, this rising service demand does not entirely balance out the ills of befallen manufacturers. Exported agricultural products face the same pressure as exported manufactured goods.

As noted, Max Corden and Peter Neary laid out the *theoretical* model of Dutch Disease in 1982. An abbreviated version by Corden in 1984 appears in Table 1.⁴

Table 1, Max Corden’s (1984) Description of “Core Model” of Dutch Disease

There are three sectors, the Booming Sector (B) [i.e. the resources sector], the Lagging Sector (L) [manufacturing and perhaps agriculture] and the Non-Tradeable Sector (N). The first two produce

³ W. Max Corden and J. Peter Neary, “Booming Sector and De-Industrialisation in a Small Open Economy,” *The Economic Journal*, 92 (Dec. 1982), pp. 825-848.

⁴ The rationale for my lengthy passage in this table will become obvious to readers in paragraphs to follow. A hint, there is very contentious debate among economists about the existence of Dutch Disease as an observable, measurable phenomenon, and there is even much confusion over what the concept represents and whether it is important.

tradeables facing given world prices. Output in each is produced by a factor specific to that sector and by labour, which is mobile between all three employments. ... All factor prices are flexible and all factors are internationally immobile.

A boom in B has the initial effect of raising aggregate incomes of the factors initially employed there. This boom can be thought of as happening in one of three ways. 1) There has been a once-for-all exogenous technical improvement in B, represented by a favourable shift in the production function, this improvement being confined to the country concerned. ... Unless otherwise indicated, we have case (1) in mind below.

Spending Effect. If some part of extra income in B is spent, whether directly by factor owners or indirectly through being collected in taxes and then spent by government, and provided the income elasticity of demand for N is positive, the price of N relative to the prices of tradeables must rise. This is a *real appreciation*. It will draw resources out of B and L into N, as well as shifting demand away from N towards B and L. ...

Resource Movement Effect. In addition, the marginal product of labour rises in B as a result of the boom so that, at a constant wage in terms of tradeables, the demand for labour in B rises, and this induces a movement of labour out of L and out of N. This effect has two parts.

1) The movement of labour out of L into B lowers output in L. This can be called *direct de-industrialisation* because it does not involve the market for N and thus does not require an appreciation of the real exchange rate.

2) There is a movement of labour out of N into B at a constant real exchange rate. ... The resource movement effect has shifted along the supply curve ... and thus creates excess demand for N additional to that created by the spending effect, and brings about real appreciation. Thus it brings about an additional movement of labour out of L into N, reinforcing the de-industrialisation resulting from the spending effect. The two effects combined, leading to a movement of labour from L to N, bring about, what can be called, *indirect de-industrialisation*, which supplements the direct de-industrialisation that resulted from the movement of labour from L to B.

Coming to factoral income distribution, both effects lower the real rents of the specific factor in L, this being the essential problem of the Dutch Disease. ...

It has to be underlined that the Lagging Sector [e.g. manufacturing] can be producing both non-boom exportables and importables, and it need not consist only of manufacturing industry. In Australia and Nigeria, for example, a significant component would be producing tradeable agriculture products. The term “de-industrialisation” can thus be misleading (with a major effect possibly being de-agriculturalisation!) and should be regarded as no more than shorthand.

Source: W. M. Corden, “Booming Sector and Dutch Disease Economics: Survey and Consolidation,” *Oxford Economic Papers*, 36 (1984), pp. 360-363.

I want to place some emphasis on this idea of Dutch Disease being a theoretical construct and not necessarily an empirical certainty, at least in terms of comprehensive cause and effect. Some commentators using the construct as a blunt instrument for criticisms of state induced or permitted resource booms are inclined to observe that the Dutch Disease is always a “contributor” to declining

manufacturing exports and domestic manufacturing employment when these booms occur. Other more sanguine commentators are inclined to observe that resource booms are not the *single cause* of declining manufacturing exports and employment; other things are going on. This tension between competing perspectives is the basis of the Canadian debate, as we shall see. And so, while much empirical work has been carried out on Dutch Disease – particularly on and inside Canada – there is no consensus on ailment’s empirical outcomes.

And so I come to the first interesting observation about the phenomenon. Even the original contributors on the subject were not able to convince themselves that Dutch Disease, as theoretically agreed upon, actually occurs as the model(s) suggests, even in The Netherlands. A marvellous contribution by international technocrat and later Dutch banker Jeroen Kremers makes the case that the export strengths of the Dutch economy from the 1960s to the 1980s tended to be in “mineral fuels, lubricants, related materials and chemicals.” He writes:

As it happens, the exploitation of Dutch gas ... required limited inputs. The gas sector does not provide much employment. ... Therefore, the Dutch Disease in The Netherlands may be studied in a model without inputs to the booming sector.⁵

According to Kremers, in The Netherlands during the heyday of Dutch Disease not much of the ailment was contracted. Further, he observes that “gas export prices [were] ... below world energy equivalent prices, and before 1973 [the first year of the international oil shock], domestic prices were far below world levels.”⁶ Moreover, *manufacturing outputs actually grew faster than services during the period 1963-73*. A turnaround did occur in 1976 after the first oil embargo, but most Dutch manufacturing was “involved in exporting, or at least exposed to import competition.”⁷ The later decline ... “was partly due to

⁵ Jeroen Kremers, “The Dutch Disease in The Netherlands,” in Peter Neary and Sweder Van Wijnbergen, Ed., *Natural Resources and the Macroeconomy*, Cambridge: The MIT Press, 1986, pp. 97-101.

⁶ Ibid. p. 103.

⁷ Ibid. pp. 106 and 108.

stagnation in the EC [European Community],” and that’s when the *Economist* picked up on the change in November 1977.⁸ Then, the discussion of Dutch Disease began in earnest.

Moreover, on exchange rates, Kremers points out that monetary policy had only a relatively modest role to play in The Netherlands during this period. This stems from the size and openness of the economy. There was a very tight link between the guilder and the (German) Deutschmark. And thus it is difficult to determine to what extent Dutch exchange rate movements and policy reactions were connected to the gas boom. The link with the Deutschmark was the overriding monetary policy goal, says Kremers.⁹

Kremers offers a great deal more to distinguish the theoretical construct of Dutch Disease from actual conditions in the Dutch economy during the decade before and after the *Economist*’s declaration. I want to wrap up this section of the discussion of the Dutch case by pointing out that the lasting effects of Dutch Disease, to the extent that it can be empirically tracked, concerned the *policy choices made by Dutch governments*. The government’s share of gas revenues rose from 65% to 85% and so there were huge revenue inflows from the gas fields and *most of this money went to consumption*, that is, according to Kremers (and even Corden) consumptions *qua* welfare spending starting in the mid 1970s.¹⁰ The welfare state in The Netherlands grew significantly and in effect became the semi-permanent feature of Dutch Disease.

The Canadian Debate on Dutch Disease

While some might justifiably trace the discussion of Dutch Disease in Canada back a decade or two, controversy over the concept, where the term was actually specified in public, began with Thomas Mulcair’s article in *Policy Options* magazine in March 2012. At the time, Mulcair, a Quebec M.P. and leadership contender for the national New Democratic Party launched a partisan tirade against the Government of Stephen Harper, the development of the Alberta oil sands, and “dirty oil.” In this

⁸ Ibid. pp. 111 and 108.

⁹ Ibid. pp. 118-119

¹⁰ Ibid. pp. 103-104.

undisciplined rendering – a curious privilege granted by the editors of *Policy Options* – Mulcair actually offers only passing reference to Dutch Disease. He states that the Dutch Disease “since the 1960s” causes a “meteoric rise in the value of the local (sic) currency, the guilder, and [makes] exporting other products difficult (sic). Indeed, [The] Netherlands manufacturing sector soon collapsed,” he says.¹¹ (As we know from Kremer’s commentary above, none of these things were true.) Mulcair then proceeds to mix in the cyclical decline of manufacturing jobs, mainly coming from the auto sector, with Dutch Disease effects, and finishes off his piece declaring that the “tar sands might now be taking more money out of the economy than they are putting in.”¹²

Perhaps as important as Mulcair’s contribution, one month before in response to Alberta Premier’s Allison Redford’s somewhat odd plea for symbolic political support of oil sand development, Ontario Premier Dalton McGuinty suggested the following: “If I had my preferences as to whether we had a rapidly growing oil and gas sector in the west, or a lower dollar benefiting Ontario, I can tell you where I stand – with a lower dollar.”¹³ As might be expected, the Western and Central Canadian news and opinion media exploded in alternating fury and delight.¹⁴ McGuinty sort of half back-tracked on his diplomatic *faux pas* within days, and seven months later sent his Finance Minister Dwight Duncan out to Calgary to apologize for the Premier’s remarks. Duncan, on cue, feigned surprise and delight about how many manufactured goods the Western energy industry purchased from Ontario firms.¹⁵ The debate in the media fizzled out in early 2013. In January 2013 we were back to the world of marginally sub-par Canadian exchange rates with the U.S. dollar, after being over-par since January 2011. A lower Canadian dollar is thought by many to have beneficial effects for Canadian manufacturing exports and thus remediate Dutch Disease.

¹¹ Thomas Mulcair, “Tar Sands: Dirty Oil and the Future of a Country,” *Policy Options*, March 2012, p. 63.

¹² Loc. cit.

¹³ Kelly McParland, “Dalton McGuinty blames the dog for eating his province,” *National Post*, Feb. 28, 2012.

¹⁴ Even national Small Business Minister Maxime Bernier got into the act. See Maxime Bernier, “Let entrepreneurs tackle tailings ponds,” *National Post*, June 27, 2012.

¹⁵ Carrie Tait, “Ontario’s Duncan mends fences with Alberta over oils sands,” *Globe and Mail*, Sept. 27, 2012.

Dutch Disease in Canada, and Newfoundland & Labrador

Notwithstanding lower current exchange rates and the cooling of tempers, the Dutch Disease furore in 2012-13 did produce some useful policy analyses accompanying one or two authoritative contributions a few years before. I do not intend to review all the most serious offerings, but two stand out; one written at a Dutch economics institute and other emanating from an economics dissertation at the University of Saskatchewan.¹⁶

First, economists Michel Beine, Charles S. Bos, and Serge Coulombe in a 2009 analysis clear away much of the hyperbolic rhetoric and selective, partisan analysis on Dutch Disease.¹⁷ Their paper, compiled at the Tinbergen Institute in Holland offers the widely cited observation that “only 42 per cent of the CAD/USD appreciation [“between 2002 and 2007”] affecting Canadian employment might be ascribed to the rise in commodity prices.”¹⁸ This meant that most of the attribution of Canada’s rising real exchange rate had been due to the weakening value of the American dollar, not rising commodity (petroleum) prices. The credibility of the Beine, Bos and Coulombe paper turns on their reasonably straightforward and clean analytical method. They suggest:

¹⁶ For a review of “second tier” contributions see: Ron Parker, “The Current Resource Boom and the Canadian Manufacturing Sector,” Senior Assistant Deputy Minister, Industry Canada, for the Public Policy Forum conference, “Has the Canadian Economy Caught Dutch Disease? Implications for Canada of a High-valued Canadian Dollar,” Metropolitan Hotel, Toronto, ON, Jan. 30, 2008; Jim Stanford, “A Cure for Dutch Disease: Active Sector Strategies for Canada’s Economy,” Technical Paper, *Canadian Centre for Policy Alternatives*, March 2012; Nathan Lemphers and Dan Woynillowicz, “In the Shadow of the Boom: How oilsands development is reshaping Canada’s economy,” *The Pembina Institute*, May 2012; Philip Cross, “Dutch Disease, Canadian Cure: How Manufacturers Adapted to the Higher Dollar,” *Macdonald-Laurier Institute*, January 2013; Jim Stanford, “Dutch disease is dead, long live Dutch disease!”, *rabble.ca*, Mar. 5, 2013; Sebastian Claro, Remarks to the Symposium on Dutch Disease: Resources – Blessing or Curse?” School of Public Policy, University of Calgary, Toronto, ON, Mar. 7, 2013; Alan Gelb, “Is Dutch Disease and Myth or Should Canada Worry About the Resource Curse?” University of Calgary Symposium, Toronto, ON, Mar. 7, 2013.; Matt Krzepkowski and Jack Mintz, “Canadian Manufacturing Malaise: Three Hypotheses,” SPP Research Papers, University of Calgary, vol. 6. No. 12, March 2013; and Wardah Naim and Trevor Tombe, “Appreciate the Appreciation: Imported Inputs and Concern Over Dutch Disease,” SPP Research Papers, University of Calgary, vol. 6, no. 13, March 2013.

¹⁷ See Michel Beine, Charles S. Bos, and Serge Coulombe, “Does the Canadian Economy Suffer from Dutch Disease?”, *Tinbergen Institute Discussion Paper*, TI 2009-096/4, Amsterdam, The Netherlands, November 2009.

¹⁸ *Ibid.* p. 4.

Using the original Bayesian approach of Bos and Shepard (2006¹⁹), we extract from a set of bilateral exchange rates the currency components that capture the strength of currencies such as the CAD and USD. Significantly, our method is fully independent of the trade weights that are usually used to define effective exchange rates. It is then possible to assess whether and how much each currency component is associated with the evolution of the commodity prices. This approach in turn allows us to quantify the part of the recent loss of the Canadian manufacturing employment that is associated with the recent increase of the commodity prices, accounting for the movements of the CAD and the USD that are unrelated to the evolutions of those prices.²⁰

And yet the real strength of the Beine et al. paper is their investigation of the importance of exchanges rates “in explaining the variation in Canadian manufacturing employment,” and that different industries in the Canadian manufacturing sector have different experiences – an outcome more than hinted at by Corden and Neary in their original 1982 article.²¹ Beine et al. examine “Canadian and U.S. data for 21 industries over the 1987-2006 period,” and find that “the three industries most affected by Dutch disease are textile mills, machinery, computer and electronics products” They also observe:

Plastics and rubber, and furniture are industries that also more affected than the average by Dutch disease The manufacturing industries – paper, printing, transportation equipment ... are also affected negatively and significantly by the Dutch disease. All the affected industries, with the exception of printing, are highly exposed to international trade.²²

¹⁹ C.S. Bos and N. Shepard, “Inference for adaptive time series models: Stochastic volatility and conditionally Gaussian state space form,” *Econometric Reviews*, vol 25 no. 2-3, 2006, pp. 219-244.

²⁰ Beine, Bos and Coulombe, p. 4.

²¹ See Beine, Bos and Coulombe, p. 23, and Corden and Neary, “Booming Sector and De-Industrialisation,” 1982, pp. 836-838.

²² *Ibid.* pp. 24 and 26.

(By contrast, newsprint manufacturing in NL does indeed experience exposure to international markets.)

Further, the authors point out:

Industries that not affected by either currency component are food manufacturing, beverage and tobacco, textile products, leather and allied products, petroleum and coal, non-metallic minerals, and electrical equipment.²³

The authors conclude: “the Canadian economy has been subject to a partial Dutch disease phenomenon. It is partial in both ways: in its macroeconomic impact and partial in the sense it affected a subset of industries only.”²⁴ The authors’ final list is important for this analysis, because while the NL manufacturing sector outside of the petroleum and construction industries is not large, food manufacturing, beverage production, and newsprint manufacturing are salient industries in the province. And on these two counts, the authors claim food manufacturing and beverages have not been much affected by Dutch Disease; newsprint manufacturing is negatively affected. Let us explore further.

The economics team of Mohammad Shakeri, Richard Gray, and Jeremy Leonard compiled a paper for the *Institute for Research on Public Policy* in 2012 prompted by Shakeri’s doctoral dissertation research completed in 2009. In spite of the paper’s somewhat misapplied title, the authors also assist us mightily in identifying the effects of Dutch Disease in Canada and NL for manufacturing. In their statistical correlations from 1992 to 2007 they report:

Of the 80 industries analyzed, only 25 show strong evidence of a negative relationship between the strength of the Canadian dollar and output, in that the coefficient for the exchange rate is positive and statistically significant; 28 industries have a positive coefficient on the exchange rate, but it is not statistically different from zero. The real exchange rate had a negative effect on output in 24 industries (meaning that they benefited from the strengthening

²³ Ibid. p. 26.

²⁴ Loc.cit.

Canadian dollar), of which 9 were statistically significant Output in 3 industries was unaffected by movements in the exchange rate.²⁵

And so “of the 18 manufacturing industry groups, 11 (accounting for 55 percent of manufacturing output) saw a decline in output due to rising energy prices and the associated exchange rate increase.”²⁶ The biggest declines were in “textiles, apparel and leather products ... accounting for “less than 2 percent of manufacturing output [across Canada].”²⁷ (We note that Beine et al. found that textiles and leather products were “not affected by [the] currency component[s].”) Similar results with lesser salience occurred in “the furniture industry,” according to Shakeri et al. “Somewhat surprisingly,” the Shakeri group found that the food products industry – a large industry -- suffered from a “fairly large” and negative exchange effects; surprising since this is domestic industry “is not as heavily exposed to foreign competition.” (Seafood products in NL are indeed exposed to export markets.) Across Canada, the food products industry grew by “8.3 percent from 2004 to 2007 and therefore is not a candidate for Dutch Disease.” Moreover, “none of the three subindustries associated with automotive manufacturing ... [showed] a statistically significant relationship between output growth and energy prices.” Similarly, the negative effects of Dutch Disease in the “large heavy industry segment” such as “primary metals, fabricated metals and machinery” were “minimal.” Finally, “the lone industry group that ... benefited at an aggregate level from energy-driven appreciation of the Canadian dollar was chemical products,” mainly from the “single subindustry: pesticides, fertilizer and other chemical products (notably the Potash Corporation of Saskatchewan).”²⁸ In summary, the authors observe: “the Dutch disease effect is most pronounced in industries that are relatively small [in Canada],” e.g. to repeat, textiles, apparel and leather products.”²⁹

²⁵ Mohammad Shakeri, Richard S. Gray, and Jeremy Leonard, “Dutch Disease or Failure to Compete? A Diagnosis of Canada’s Manufacturing Woes,” IRPP Study 30, *Institute for Research on Public Policy*, May 2012, p. 14.

²⁶ Ibid. pp. 15-16.

²⁷ Ibid. p. 16. Quotations in the remainder of this paragraph up to fn. # 29 are also found on page 16.

²⁸ Ibid. p. 17.

²⁹ Loc. cit.

In NL, the leading industries apart from petroleum development and construction are seafood and newsprint. We note that Shakeri et al. found that food industry was negatively affected by Dutch Disease, but the ratio was “a 10 percent increase in energy prices [was] associated with a 1.6 percent decline in output,” and this industry segment actually grew 8.3% in the 2000s.³⁰ Shakeri et al. point out also that the paper and printing industries experienced contra-indicated positive outputs with rising exchange rates, but the statistical relationship was not significant. (Obviously, Beine et al. and Shakeri et al. disagree on the effects for the newsprint industry.) Since, the newsprint business in NL is highly export oriented, these results may be less useful. And so, in summary, what do we understand on the matter of Dutch Disease for the province of Newfoundland and Labrador?

First, manufacturing is a small, nay, a tiny component of the provincial economy: manufacturing represents 3.2% of provincial gross domestic product (GDP) and 4.9% of provincial employment.³¹ Moreover, the sector is in steep decline: in 2001 there were 757 manufacturing firms in the province (857 in 1998); however, that number has dropped to 454 in 2011 – 40% over the course of a decade.³² Beine et al. and Shakeri et al. the leading analysts, from my point of view on Dutch Disease in Canada, show us that the “disease” profile is mixed, modest and maybe marginal, when we are focussed on NL’s manufacturing sector. Is there Dutch Disease in Canada and NL: possibly, but only modestly across Canada, and improbably and nearly imperceptibly in NL. Let us now turn to the related ailment that I regard as more important for the province, the so-called “resource curse.”

The Resource Curse

The “resource curse” is a phenomenon comparable to Dutch Disease and also promoted by leading economists, and some political scientists. While these scholars typically describe the curse as bigger, grander and conceptually differentiated than the more narrowly-conceived Dutch Disease, I take a point

³⁰ Ibid. p. 16.

³¹ Newfoundland & Labrador Dept. of Finance, *The Economy*, March 2013, p. 54.

³² Economics and Statistics Branch, Dept. of Finance, Newfoundland & Labrador, *Profiling The Manufacturing Sector in Newfoundland and Labrador*, March 2003, Table 11, p. 18, and *The Economy*, 2013, p. 25.

of view somewhat at variance with this image. For me, the resource curse is an extension of Dutch Disease, conceptually and empirically. Both “phenomena” find their origins in rising and accumulating natural resource revenues accruing to state treasuries, with Dutch Disease also (in)directly affecting the value of national currency and manufacturing employment. The resource curse is the fiscal consequence of natural resource wealth, the policy and programmatic residue of cash surpluses; it is a specific set of problems experienced by national (or sub-national) governors and revenue and expenditure management bureaucrats. Political scientists, mainly, have laid down convincing grounds that the resource curse is insufficiently examined as a source of bad political decision-making and poor state performance.

My review of the literature on the resource curse has produced several categories that point to *potential pitfalls* for governments accommodating to and managing petroleum abundance. I have settled upon 1) issues related to the “rentier state,” 2) resource (management) ownership issues, 3) economic growth investment strategies and development issues, and 4) democratic accountability. Into these categories I shall offer brief commentaries coming from scholars in the field. It is these categories that will be adopted to examine conditions in Newfoundland & Labrador.

Rentier States

A “rentier state” is defined as a nation state including presumably a sub-national jurisdiction -- in a country as large as Canada -- that receives high levels of surplus revenues from highly capitalized investments within its jurisdiction that it controls or does entirely not control. Often the source of revenues is from natural resource abundance, which is received directly into state coffers. In simplest terms “rent” is the income that a landlord (the state) takes from a tenant (state enterprise or private corporation) based on the sale of natural resources e.g. oil, gas, ore, potash and so forth. Political scientist

Thad Dunning describes such rent as a “super-normal level of profit ... that exceeds labor and other production costs, as well as transport costs and some ‘normal’ return to capital.”³³

A key issue for the rentier state is “resource dependence.” Resource dependence is measured by the size of resource industry receipts as a ratio of GDP.³⁴ The problems of revenue volatility, resource depletion and thus falling revenues also come into play. Resource dependence is thought to occur when resource revenues are the “only game in town,” according to Dunning. For example, “Venezuela in the 1970s captured 80% of its revenues from the oil industry, but oil receipts were only 10-20% of GDP,” and so oil was not dominant in its economy. Whereas in Saudi Arabia during the same period, resource revenues rose to 80% levels, and so did industry receipts as a percentage of GDP.³⁵ Under these conditions, Saudi Arabia qualified as resource dependent, Venezuela could only be described as “resource abundant,” again according to Dunning.

Economist Paul Collier, however, sets the threshold for resource dependence much lower. He says:

By the time natural resource rents are around 8 percent of national income, the growth advantage of democracy is adverse. Taking a country with resource rents worth 20 percent of national income, the switch from autocracy to intense electoral competition [the first sign of a democracy] would lower the growth rate by nearly 3 percent.³⁶

Thus, resource dependence needs to be considered when rents rise between 20% and 80% of GDP.

³³ Thad Dunning, *Crude Democracy: Natural Resource Wealth and Political Regimes*, Cambridge: Cambridge University Press, 2008, p. 39. See also John Richards and Larry Pratt, *Prairie Capitalism: Power and Influence in the New West*, Toronto: McClelland and Stewart, 1979. chapter 12.

³⁴ Dunning, *Crude Democracy*, p. 16.

³⁵ *Ibid.* p. 20.

³⁶ Paul Collier, *The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It*, Oxford: Oxford University Press, 2007, p. 43.

So, why is resource dependence by a nation state regarded as an element of the resource curse? For Collier, “resource surpluses induce an excessively large public sector.”³⁷ Not only does heightened spending occur by the dependent rentier state, but the wrong kind of spending occurs.³⁸ Far too much spending occurs for example on social programs, and much too little discipline is exercised on pet state projects, i.e. “national heritage projects,” which typically are absent prudential consideration in their initiation and too little oversight occurs in later administration. Moreover, resource dependence encourages democracies to “under-invest” in useful projects for the long term or in safe foreign or domestic securities. Short-term, competitive, partisan politics distracts democracies from big picture interests and careful decision-making.³⁹ According to Collier, the lack of restraint is the problem.⁴⁰ Indeed, like Corden and Sachs, Collier worries about over-consumption and insufficient investment: the problem of “Wagner’s Law”⁴¹, rising borrowing, repeated annual deficits, unsustainable debt loads and punishing debt service charges.

Ownership Status

Many commentators have observed that oil and natural gas ownership, internationally, runs in cycles alternating between private sector dominance and state hegemony. Political scientist Michael Ross, for example, points out that as late as 1950 the major oil companies “controlled 98% of the world’s traded oil, outside the United States and the Communist bloc.”⁴² But, by the mid-1970s, state expropriations were on the rise and by 1980 “almost all developing countries had nationalized their petroleum industries and established national oil companies.”⁴³ Political scientists Pauline Jones Loung and Erika Weinthal report that since the mid-1990s many countries for a variety of reasons took a new look at foreign oil

³⁷ Loc. cit..

³⁸ Ibid. p. 44.

³⁹ Loc. cit.

⁴⁰ Ibid. p. 51.

⁴¹ See Richard M. Bird, *The Growth of Government Spending in Canada*, Toronto: Canadian Tax Foundation, 1970, p. 70. “Wagner’s Law,” suggests “as income rises in industrializing nations, their public sectors grow in relative importance.”

⁴² Michael Ross, *The Oil Curse: How Petroleum Wealth Shapes the Development of Nations*, Princeton: Princeton University Press, 2012, p. 37.

⁴³ Ibid. p. 38.

companies, and thus foreign investment has made a come-back. By 2000, the most likely emerging form of ownership to exploit natural resources was through foreign multinationals.⁴⁴

Oil contracts are a crucial management “ownership” element in the relationship between private, domestic or foreign, petroleum companies and the state. It is often forgotten that international petroleum exploration and development companies are not on “speed dial” for most resource abundant nations, developing or developed. The terms for exploration and development need to be favourable for such companies to spend years in up-front exploration and development, and hundreds of millions of dollars over even billions in E&D. Energy consultant David Johnston reminds us that there are nominally two broad types of contracts between private interests and state defined as management “ownership.” Concessionary contracts (e.g. production licensing) are popular, and used by Canada and NL. In this case “government grants the company the *right* (my emphasis) to take control of the entire process – from exploration to marketing -- within a fixed area for a specific amount of time.”⁴⁵ Royalties, corporate income taxes, and other liens are collected by the state in return for the use of this “bundle” of property rights – effectively an elaborate leasehold agreement. Contractually-based agreements are the second group and include “production-sharing contracts” and “service agreements.”⁴⁶ Johnston says that notwithstanding the nominal difference between the two, there are practically no real contractual differences. The real issue turns on “where, when and if *ownership* of hydrocarbons transfers to the international oil company.”⁴⁷

Luong and Weinthal treat the matter of ownership as crucial. For them, petroleum, *per se*, does not lie at the root of the resource curse it is the ownership model of the petroleum that is most important. The authors explore four ideal types of resource ownership: “state ownership with full control,” “state ownership without [full] control” i.e. with regulatory oversight and administrative mandates, “private

⁴⁴ Pauline Jones Luong and Erika Weinthal, *Oil Is Not A Curse: Ownership Structures and Institutions in Soviet Successor States*, Cambridge: Cambridge University Press, 2010, p. 182.

⁴⁵ David Johnston, “How to Evaluate the Fiscal Terms of Oil Contracts,” in Macartan Humphreys, Jeffrey Sachs and Joseph Stiglitz, Ed., *Escaping the Resource Curse*, New York: Columbia University Press, 2007, p. 56.

⁴⁶ Loc. cit.

⁴⁷ Loc. cit.

domestic ownership,” and “private foreign ownership.”⁴⁸ Each ownership structure facilitates a distinct fiscal regime, “strong, weak or hybrid,” a set of politics and distinct patterns for positive or negative effects in the outcomes of resource exploitation. Each fiscal regime produces and shapes causal influences that the authors view through the lens of “transactions costs,”⁴⁹ societal expectations,⁵⁰ and specific “power relations.”⁵¹

State ownership with control, typically state enterprises, tends to create a *weak fiscal regime*, since there are no incentives to “constrain” or “enable” the state. According to Luong and Weinthal, there are low transaction costs (e.g. little incented interest by domestic political and bureaucratic elites to constrain themselves or enable controls on fiscal expansion), and there are high societal expectations by residents for a full state role and significant spending on community benefits and services. Moreover, power relations are set on a course of interdependence between the state agencies and energy companies, which encourages implicit internal bargaining on distributional outcomes of resource largess among “domestic elites” (political and bureaucratic officials including state enterprise managers). This pattern “fosters the mutual desire to hide information from the public, which degrades transparency and “increases the opportunities for [patronage, nepotism] and corruption.”⁵²

State enterprise ownership without (full) control refers to state enterprises or government ministries, which merely regulate foreign owners of domestic resources and collect revenues from the

⁴⁸ Ibid. p. 45.

⁴⁹ “Transaction costs are a function information symmetries or asymmetries between the management owners of the resource and the central state apparatus. These symmetries or asymmetries shape interests and behaviour. When information asymmetries are high, they elevate the costs of exchange and thereby foster a desire on the part of political and bureaucratic actors to create institutions to help minimize these costs.” Luong and Weinthal, p. 50.

⁵⁰ “Social expectations” refer to demands by the public for more, less or no additional public spending on state benefits and services coming from oil/gas developments. Luong and Wienthal, pp. 58-59.

⁵¹ “Power relations” are the grease on wheel once transaction costs and social expectations have been settled. Here Luong and Weinthal use a simple model reminiscent of Charles Lindblom’s, *Politics and Markets*, New York: Basic Books, 1977 i.e. power is exercised by” implicit or explicit bargaining, or by pure coercion.” (pp. 70-71) Just a reminder for readers: all power is relational; power cannot operate in a vacuum; it is always bi-polar or multi-polar; even absolute power is relational as tyrants need subjects to rule.

⁵² All references to “state ownership with control” and “private domestic ownership” are taken from Luong and Weinthal, chapter 3, pp. 46-49.

sales of petroleum, without managing much.⁵³ This model of ownership produces a *hybrid fiscal regime*, meaning that there are tensions and variability in the transaction costs, societal expectations and power relations. The introduction of a “model contract”⁵⁴ stabilizes and polarizes the state-foreign sector relationship. We can expect low initial transaction costs given the presence of binding features of the “model contract.” However, the problem of the “obsolescing bargain” does enter the picture later on leaving foreign investors somewhat disadvantaged as states constantly push for more flexibility and to gain more control on key elements of the model contract. Given initial low transactions costs, strong fiscal institutions are eschewed, and patronage, nepotism and corruption are ever-ready prospects. Societal expectations for regulatory controls are high but low for major public spending by foreign investors. Moreover, international non-government organizations and international financial institutions tend to push for elevated concern on resource management and redistribution of benefits. This can heighten social expectations, aided by such campaigns as “Publish What You Pay” and Corporate Social Responsibility directed at foreign oil companies. On the power relations front, this model tends to evoke more “coercion,” because state ownership is controlled by the model contract and the model contract tends to support up zero-sum gaming. The prospect of coercion from the either side tends to encourage “dependent power relations.” Both parties can unilaterally enforce provisions of the model contract, and so both tend to be very accommodating, or perhaps not so, in order to make the relationship work or fail. In the end, the state enterprise has considerably less than full discretionary power over management of the resource and therefore not much build-up of management or the financial apparatus of the state actually occurs.

Private domestic ownership lends itself to *strong fiscal regimes* as transaction costs are high, due to a lack of trust between state and private agents. There are low social expectations on increasing public

⁵³ All references in the succeeding paragraphs to “state ownership without control” and “private foreign ownership” are taken from Luong and Weinthal, chapter 6.

⁵⁴ The “model contract” is a contractual instrument now used widely around the world between states and petroleum developers and marketers to regulate their commercial affairs; the model contract offers the legal boiler-plate on the commercial transaction(s).

spending, because citizens recognize the scope of investors' private property rights, and therefore there is less demand for significant expansion of government benefits and services. A conservative fiscal regime emerges. Power relations are set up to engage in "explicit bargaining" between state and private interests, which along with high transactions costs encourages the build-up of fiscal/financial state institutions emphasizing regulation and monitoring for "greater fiscal transparency [and] accountability."

Private foreign ownership produces a set of circumstances where the foreign oil companies explore, develop, extract, and sell the resource and dominate the management function of resource development. Foreign investors are usually "granted wide-ranging concessions." This model offers the least regulatory oversight; the state is mainly a revenue collector, and it produces a *hybrid fiscal regime*. Transactions costs are low because of the model contract; again the rights and obligations of this contract between and the state and foreign investor(s) keep the game simple and straightforward; each subject to the other's unilateral coercive power to enforce the contract. Societal expectations are high under this model and there is pressure for the model contract to accommodate demands for transparency, corporate social responsibility, funding on projects in local communities, and local hiring agreements. Power relations, given mutual dependence, are unilaterally coercive for both parties, and thus forms of cooperation are pursued without much institutional build-up.

In summary, as we know, Luong and Weintal place the emphasis on ownership models to forecast strong, weak, or hybrid fiscal regimes. So for them it is the possibility of a "curse" of institutional growth and over-reach, institutional ineffectiveness or incompetence, and institutional costliness and indebtedness. There is also the problem of the use of institutions as symbolic action, as the objects of patronage and corruption or merely inappropriate state-building e.g. the use of institutions as pet state projects or more benignly "national heritage projects." In the absence of the curse of institutions, fiscal regimes may perform with deliberateness, efficiency, stability, functionality and prudence.

Early, leading voices on the resource curse were economists Jeffrey Sachs and Andrew Warner. In 1995, Sachs and Warner introduced their readers to the idea that “resource-poor economies often vastly outperform resource-rich economies in economic growth.”⁵⁵ And so, the resource curse for Sachs and Warner is lower economic growth rates for countries exporting large amounts of resources. The authors state:

The basic pattern is evident in a sample of 97 developing countries ..., where we graph each country’s annual growth rate between 1970-89 in relation to the country’s natural resource-based exports in 1970, measured as a percent of GDP. Resource-based exports are defined as agriculture, minerals, and fuels. On average, countries with a high value of resource-based exports to GDP tend to have a lower growth rate.⁵⁶

A few years later, Sachs and Warner declare that: “*the curse of natural resources is a demonstrable empirical fact.*”⁵⁷ They proceed to replicate the Corden and Neary “crowding out” explanation for the curse – not just Dutch Disease.⁵⁸ The leading group crowded out is entrepreneurs and therefore innovation -- “if wages in the natural resource sector rise high enough to encourage potential innovators and entrepreneurs to work in the resource sector.”⁵⁹ In 2007, Sachs moderated his position somewhat; he said that oil being a curse is “only partly true.” He held that if oil revenues are “invested” in a nation’s patrimony, its physical and human infrastructure, the benefits of oil abundance can be plain to see.⁶⁰ In

⁵⁵ Jeffrey D. Sachs and Andrew M. Warner, “Natural Resource Abundance and Economic Growth,” NBER Working Paper Series, # 5398, *National Bureau of Economic Research*, December 1995, p. 2. At this juncture, Sachs and Warner do not actually use the term “resource curse.”

⁵⁶ Loc.cit.

⁵⁷ Jeffrey Sachs and Andrew Warner, “The Curse of Natural Resources,” *European Economic Review*, vol. 45, 2001, p. 828.

⁵⁸ *Infra*, Table 1.

⁵⁹ Sachs and Warner, “The Curse,” p. 835.

⁶⁰ Jeffrey Sachs, “How to Handle the Macroeconomics of Oil Wealth,” in Humphreys, Sachs and Stiglitz, Ed., *Escaping the Resource Curse*, pp. 173-174.

fact, he said, “oil earnings in low income countries should be turned into *public investments* rather than into increased private consumption.”⁶¹

However, more than one analyst has worried about governing elites getting their hands on public money for pet state projects. Far too often these projects are referred to as public “investments” when they are nothing of the sort. Proper economic impact assessments are rarely carried out; discounted present valuing is mostly overlooked, and ROIs are never really contemplated. So-called “investments” end up being “exhaustive expenditures,”⁶² and too often end up as embarrassing public boondoggles. In the past, Atlantic Canada has been the recipient of dozens of these kinds of projects, and in Newfoundland and Labrador there has been an unfortunate and sorry history on returns from public “investments.” The Upper Churchill Falls hydroelectric project immediately comes to mind. “Natural resource states rarely become developmental states.”⁶³

Other sinkholes include the problem of economic “enclaves.” Ross, Auty and many others point out that petroleum businesses tend to work in an isolated fashion, not just geographically isolated on ocean platforms miles from shore, but isolated in their host economies, and thus offer precious little benefit for local economies. Moreover, the petroleum industry is extremely capital-intensive and so local labour expansion is not the norm; as many have noted petroleum projects tend to generate few backward linkages.⁶⁴

Resource-based industrialization solves some of the enclave problem, when RBI is operating properly. Resource-based industrialization (i.e. up and downstream industrialization, e.g. fabrication

⁶¹ Ibid. pp. 176-177.

⁶² Richard Bird, *The Growth of Government Spending in Canada*, pp. 19-20.

⁶³ See Richard M. Auty and Alan H. Gelb, “Political Economy of Resource Abundant States,” a paper prepared for the Annual Bank Conference on Development Economics, Paris, France, June 2000; Richard M. Auty, *Resource-Based Industrialization: Sowing the Oil in Eight Developing Countries*, Oxford: Clarendon Press, 1990, especially chapter 12, and Mohamed Ismail Ahmad, *Foreign Manufacturing Investments in Resource-Based Industrialization*, Institute of Southeast Asian Studies, 1990. On developmental states see Meredith Woo-Cumings, Ed., *The Developmental State*, Ithaca: Cornell University Press, 1999, and Kimble F. Ainslie, *Financing the Gap: Small Capital and State Economic Development in Canada*, Toronto and Copenhagen: The Copenhagen Institute, 2007.

⁶⁴ Michael Ross, *The Oil Curse*, pp. 44-45.

plants, oil refineries, steel plants, LNG plants) is a natural choice for resource and rentier states, and potentially harmful to the resource curse. The RBI idea suggests that high reliance on resources is a good thing and that the processing of these resources or their industrialization is a better thing. In Canada, we have long been reminded by left wing political economists that as a nation we should not choose to be “hewers of wood and drawers of water.” And so, huge investments have been made into RBI in the hopes of making an economy more viable and long-lasting. Richard Auty has demonstrated that for developing nations these results are certainly not guaranteed and an unbalanced approach toward RBI can leave an economy impoverished and considerably worse off than simply relying on resource rents exclusively -- particularly if the resource is high rent petroleum.⁶⁵ Auty cites several problems for RBI in small developing countries (and prospectively for NL):

[T]he smaller the country ... the lower the domestic revenue retention, ... the smaller the forward linkage ... and the greater the reliance on export sales ... the more damaging the negative spillover effects from a poor RBI investment ... the less the scope for avoiding politically sensitive dependence on [multi-national corporations] for investment, technology and marketing.⁶⁶

According to Auty, after an examination of eight developing countries: “[w]ith few exceptions, RBI [makes] a disappointing contribution to the oil-exporting countries’ economic growth, structural change, and geographical decentralization.”⁶⁷

This leads us to my final perspective on energy resource development, the adoption of “natural resource funds” i.e. saving a portion of earnings in a state fund for investment purposes in securities domestically or abroad. Similar funds are fully entrenched in the State of Alaska, fittingly in Alberta, and

⁶⁵ Auty, *Resource-Based Industrialization*, p. 266.

⁶⁶ *Ibid.* pp. 253-254.

⁶⁷ *Ibid.* 251.

in some other developing countries.⁶⁸ Political scientist Macartan Humphreys and his associate Martin Sandbu argue that these funds are often not attractive to politicians and senior bureaucrats because they restrict the state's freedom of decision-making on fiscal matters, particularly on managing resource rents in the short-term.⁶⁹ Stuffing money into a rainy day fund means there is less money for public consumption, and less money for politicians to distribute to provincial constituents in the short term. Indeed, this observation on the orientation to turn resource rents into consumption was clearly articulated by Max Corden in his early work on Dutch Disease.

Democratic Accountability

Michael Ross is one of several political scientists who worry about the negative effects of the resource curse on democratic governance. His early thesis based on research of 113 countries over the period 1971 to 1997 holds that "oil impedes democracy." He argues:

[O]il does greater damage to democracy in poor states than in rich ones, [and] ... oil inhibits democracy even when exports are relatively small, particularly in poor states. ... Resource wealth itself may harm a country's prospects for [democratic] development.⁷⁰

Leading exceptions to "anti-democratic effects" are advanced industrialized states such as "Norway, Canada, and Great Britain, which have high incomes, diversified economies, and strong democratic institutions" -- although for NL this assumption is vetted later in this paper.⁷¹

Political scientist Terry Lynn Karl represents a shift to a more in-depth and perhaps a more strident set of observations about the nature of the resource curse and democracy. An observation she

⁶⁸ See Macartan Humphreys and Martin Sandbu, "The Political Economy of Natural Resource Funds," in Humphreys, Sachs and Stiglitz, *Escaping the Resource Curse*, chapter 8.

⁶⁹ *Ibid.* p. 196.

⁷⁰ Michael L. Ross, "Does Oil Hinder Democracy?", *World Politics*, vol. 53, April 2001, p. 356 and 328. Later Ross backs off his categorical position and moves to a somewhat more moderate view: "petroleum does not *inevitably* (his emphasis) block democratic freedoms" Michael L. Ross, *The Oil Curse*, pp. 63, 72, 74-76.

⁷¹ Michael Ross, *The Oil Curse*, p. 2.

frequently makes is the curse is a fundamentally *political* phenomenon as opposed to being exclusively economic. She argues:

Simply stated, petroleum dependence turns oil states into “honey pots” – ones to be raided by all actors, foreign and domestic, regardless of long-term consequences produced by ... collective rent-seeking. ... [K]leptocracy comes to rule, development possibilities are horrifically squandered, opposition rises and regimes eventually cannot be stabilized, producing a higher propensity in oil-exporting countries for conflict and war.⁷²

For citizens, political detachment begins to set in as “patronage and corruption become the name of the game.” Karl elaborates on citizen reactions:

Because petrodollars are not “their” money, citizens are not motivated to ensure that state revenues are well spent; they are not engaged, and they seldom demand better monitoring of the utilization of revenues. Like their rulers, they too often become addicted to their share of oil rents even as a type of permanent disconnect between the state and its subjects sets in.⁷³

There is also the related issue of declining reliance on taxation from individuals i.e. the personal income tax. If citizens have no or little skin in the game, their motivation to seek accountability from the state is at a low ebb and diverted away from attending to financial decision-making by the state on their behalf. Economist Paul Collier argues that large resource revenues “radically reduce the need to tax.” He says:

Because resource-rich countries do not need to tax [or choose not to] they do not provoke citizens into supplying the public good of scrutiny over how

⁷² Terry Lynn Karl, “Ensuring Fairness: The Case for a Transparent Fiscal Social Contract,” in Humphreys, Sachs and Stiglitz, Ed., *Escaping the Resource Curse*, pp. 257 and 260. See also Terry Lynn Karl, *The Paradox of Plenty: Oil Booms and Petro-States*, Berkeley: University of California Press, 1997.

⁷³ Terry Lynn Karl, “Ensuring Fairness,” p. 264.

their taxes are to be spent. ...What gets undermined is not electoral competition but the political restraints on how power is used. We found that resource rents gradually erode checks and balances.⁷⁴

And so, over time, three kinds of political deficits show up: “information deficits” on taxes and spending, “monitoring deficits,” i.e. the decline of appropriate revenue monitoring for accountability purposes, and “participation deficits,” where the representation disconnect between citizens and states becomes a manifest problem.⁷⁵

Effects for Newfoundland & Labrador

In June 2013, the Conference Board of Canada reported that NL occupied the top economic spot in Canada – a “runaway leader” in economic growth with a rate of growth likely to hit 6% by the end of 2013 and 3.4% in 2014.⁷⁶ And yet, about the same time the NL Government undertook a significant public spending cut-back scheme, including a public service reduction of 1200 jobs, in order to control a predicted \$564 million annual deficit.⁷⁷ These contrasting images capture the position of a Canadian province essentially reliant on a natural resource economy for about one-third of provincial revenues, and 40-45% of GDP. Is the resource curse in operation here? We shall see by taking a closer look at NL as a rentier state, its resource ownership structure, in particular, its management ownership manifested through the distribution of resource concessions (production licensing), the details of economic growth, investment behaviour, its off-shore resource developments, and the province’s performance on democratic accountability related to resource development.

⁷⁴ Paul Collier, *The Bottom Billion*, pp. 46-47. See also Michael Ross, *The Oil Curse*, p. 68; Terry Lynn Karl, *Paradox of Plenty*, p. 190.

⁷⁵ Terry Lynn Karl, “Ensuring Fairness,” pp. 264-265. Social psychiatrists George Ainslie and Nick Haslam have developed a concept that captures some of this citizen alienation: “hyperbolic discounting.” It refers to the natural inclination of individuals to put off future costs of decision-making and action on public issues in favour of what might be readily available at less cost currently. See George Ainslie and Nick Haslam, “Hyperbolic Discounting,” in John Elster and George Lowenstein, Ed., *Choice Over Time*, New York: Russell Sage Foundation, 1992.

⁷⁶ Barrie McKenna “Newfoundland and Labrador economy Canada’s ‘runaway leader’: forecast,” *Globe and Mail*, June 12, 2013.

⁷⁷ Sue Bailey, “Newfoundland and Labrador budget cuts jobs, costs as deficits mount,” *Globe and Mail*, March 26, 2013.

NL As A Rentier State

That NL is a rentier (sub-national) state can be taken as a given according to oil production, provincial revenue, and GDP figures reported below. NL's rentier state origins began with "full production" of the off-shore in 2002 (104,333,624 barrels).⁷⁸ But, to what extent is the resource curse at play because it is a rentier state? Let us examine the relevant data.

Oil Production, State Revenues and Resource Dependence

First, NL relies on off-shore oil production for a significant portion of its revenues and provincial GDP notwithstanding recent annual declines. Currently, there are three producing oil fields off the southeastern coast that produced 72.2 million barrels of oil in 2012, down 25.8% from 2011 – and well below production highs of 134 million barrels in 2007.⁷⁹ Out of this oil production, the Government captured 27.3% of annual provincial revenues in 2012. Since budget year 2007-08, when an enriched royalty regime began, average annual revenues have been 31.4% of NL's budgets.⁸⁰

So, on average, about 31% of provincial annual revenues come from oil wealth, of which another 2-3% can be added in revenues from minerals extraction.⁸¹ Revenues from oil production experienced a \$200-300 million hit in 2012-13, because of maintenance shut-downs and natural declines in production in all three oil fields. Revenues were also off by nearly 7% in budget year 2009-10. However, apart from these two aberrations, there has been precious little "boom and bust" in NL's resource rents. Indeed, natural resource revenues have been quite stable since budget year 2007-08. We do have to acknowledge that full off-shore oil production has occurred over a fairly short period of time, since 2002. And, we also must acknowledge that aggregate production in the off-shore will suffer significant depletions beginning

⁷⁸ See oil production table offered by the Economics and Statistics Branch of the NL Statistics Agency, posted July 8, 2013.

⁷⁹ Government of Newfoundland & Labrador, *The Economy, 2013*, Dept. of Finance, March 2013, p. 1; The Hon. Jerome Kennedy, Minister of Finance and President of the Treasury Board, *Securing the Future: A 10-Year Sustainability Plan for Newfoundland & Labrador*, Government of Newfoundland & Labrador, Mar. 26, 2013, p. 9, and see table referenced in previous note.

⁸⁰ See Budget *Estimates* for the province from 2007-08 to 2013-14.

⁸¹ See Budget *Estimates*, 2008-09 to 2013-14 and *Securing the Future*, p. 7.

around 2025-26 – currently, production is expected to fall to around 20 million barrels per year in 2032-33. Thus, the horizon for the province’s good fortune and the foundation of the rentier state stretches out only “about 20 years.”⁸²

On the measure of “resource dependence,” as noted, we must take account of industry receipts as a percentage of GDP. We note that NL has a moderately high level of resource receipts as percentage of GDP; the figure is 43.1% for 2011. Annual receipts coming from the resource sector took a deep dive in 2009, the year the recession hit the hardest, and these figures have tracked the slow rise of the North American economy since 2009. As a proportion of GDP, resource receipts amounted to 47.9% in 2007, 51.1% in 2008, 34.2% in 2009, and 39.0% in 2010. These figures combine oil extraction and mining receipts.⁸³ Is the provincial economy resource dependent and therefore likely to fall into the chasm of the resource curse? The average of resource receipts from 2007 to 2011 (when figures are last available) is 43%. This average figure does not describe an economy that is all but completely reliant on resource production: 43% is not 80%, for example, compared to Saudi Arabia in the 1970s. But Paul Collier implies that an 80% threshold is far too high. Rent levels at 20% of GDP are good enough to begin to see negative effects on state performance. Since an average 43% of NL’s economy is dependent on resource extraction, it is certainly within the range of resource dependence -- seven percentage points less than half the provincial economy being committed/captured by resource revenues. Therefore, I would judge that NL is within the range of economic risk, particularly since the off-shore oil tap may start to shut down in about 20 years. Not only is NL a rentier state, it is also effectively resource dependent, and thus a candidate for the resource curse.

⁸² *Securing the Future*, p. 15. In Sept. 2013, Statoil and its partner Husky Oil announced a new off-shore oil find in the Flemish Pass Bass, called Bay du Nord oil field, possibly NL’s third largest oil discovery. Obviously, the 20 production horizon will have to be amended in NL’s energy development plans if the Bay du Nord field lives up to current expectations. See Jeffrey Jones, “Oil find boosts Nfld. Offshore prospects,” *Globe and Mail*, Sept. 26, 2013.

⁸³ *The Economy*, 2009-2013.

Public Spending, Deficits and Debt

Moving on to the public spending issue, how should we judge provincial performance? As we cast our eyes over spending figures, two features quickly become apparent: NL has experienced ever-rising government expenditures consistently above inflation over the last decade, and this spending pattern has been a regular and stable feature over these years – not dissimilar to many other Canadian provinces and the national government. Spending rose just about 55% from budget year 2004-05 to 2013-14, averaging 5.5% per annum.⁸⁴ Moreover, social spending (health, education and social welfare) as a proportion of total annual budget spending has the same composite feature as general spending: it is rising, regular and stable. Indeed, almost every year from budget year 2005-06 to 2013-14, social spending comes in at about two-thirds of provincial totals. Moreover, in the medium-term, it did not seem to matter whether equalization payments were financing this bill of lading or natural resource revenues. So at first blush, we might suggest that this pattern does not have much to do with resource revenues.

We also see that “public administration” “investments” – actually exhaustive expenditures⁸⁵ -- are registering at a steady \$600-800 million per year in the province.⁸⁶ The Kathy Dunderdale Government openly refers to this kind of spending as overcoming the so-called “infrastructure deficit”⁸⁷ – similar to the language used by Alberta Government leaders since the mid 2000s. We can surmise that the rationalization for high spending is made easier when oil revenues started gushing into the treasury. A major Government planning paper makes the point:

Prior to 2003, there was insufficient investment to meet public demands for enhanced programs and services and infrastructure improvements. As a result, the 82% growth in provincial revenues since 2003-04 was used to fund an increase in program expenses of 75% growing from \$3.8 billion in

⁸⁴ See NL *Estimates* from 2003-04 to 2013-14.

⁸⁵ For a definition of exhaustive expenditures see Richard Bird, *The Growth of Government Spending*, pp.19-20.

⁸⁶ Statistics Canada, “Capital Expenditures by Sector, By Province and Territory, Newfoundland and Labrador, 2009-2013,” Feb. 27, 2013.

⁸⁷ *Securing the Future*, p. 3.

2003-04 to \$6.6 billion in 2012-13. This growth rate is high relative to an increase in CPI [consumer price index] of 20.4% over that same period. Growth in public expenditure has far exceeded the general level of inflation that has occurred in Newfoundland and Labrador during this period. This was deliberate and necessary to lay the foundation for future growth and the development of our province.⁸⁸

It may be the case that this rising, regular and stable spending pattern has as much to do with entrenched spending norms inside the provincial bureaucracy and Cabinet. In the end, since all revenue is fungible, and since resource revenues became dominant starting 2007-08, resource rents were certainly “financing” significant current spending during the post-2008 rentier state period.⁸⁹

On provincial deficits, during the 10-year period after 2003-04, the Government produced five deficit budgets and five surplus budgets. Notably, surplus budgets were produced in 2007-08 and 2008-09 at the beginning and middle of the most recent recession, but deficits cropped up in the most recent affluent years, 2012-13 and 2013-14. This somewhat odd counter-cyclical pattern strains understanding – even with the rationalization of “infrastructure deficits;” and again it does not appear to have much relationship with the stability of 31% annual resource revenues.

The good news is the Province “reduced [its] net debt by 28% from a high of \$11.9 billion in 2004-05 to \$8.6 billion in 2012-13, and it reduced its debt service payments from “23 cent of every dollar [raised in 2003-04] ... to 10.9 cents in 2012-13.”⁹⁰ So far so good, but in another quirk of fiscal decision-making, the Province reduced overall taxation by \$500 million for citizens and companies from 2007, but continues to face the pressure of \$800 per annum in debt servicing.⁹¹ Why reduce taxation when an average 11-12% of the annual budget is taken up in debt service charges? Or for that matter, why keep

⁸⁸ Ibid. p. 9.

⁸⁹ It ought to be noted that during this period oil production peaked in 2007. See NL Economic Research and Analysis Branch data posted July 19, 2013.

⁹⁰ *Securing the Future*, p. 3.

⁹¹ *Securing the Future*, pp. 4-5.

provincial personal income taxes at a low aggregate contribution (an average 13% per annum from 2007-08), or why retain a social spending envelope at a steady two-thirds of the budget when the debt overhang is obviously so punishing. Even for Progressive Conservative Governments inclined to neo-Red Toryism⁹², there is nothing laudable about profligate spending in good times, particularly when counter-cyclical measures beckon.

Resource Ownership

In contrast to Loung's and Weinthal's "ideal" model for private foreign ownership, the three active off-shore oil fields in NL (Hibernia, Terra Nova, White Rose) and the one coming on-stream in 2017 (Hebron) are jointly "owned" in the majority by private foreign investors along with minority holdings held by a Canadian private domestic corporation (Suncor Energy), two national state holding companies (Canada Hibernia Holding Corporation (Can.) and Statoil Hydro (Nor.) and an NL state enterprise, Nalcor Energy.⁹³ The (management) ownership division is about two-thirds to three-quarters private foreign, and one-quarter to one-third private domestic and state owned.⁹⁴ And so for this reason Loung's and Weinthal's ideal model is re-crafted for NL dating back to 1985. NL's off-shore is essentially a private foreign majority ownership structure, supported by private/domestic, public/foreign and public/domestic minority shareholdings, and thus it is a *hybrid foreign model*.

⁹² For a definition of red toryism, see George Grant, *Lament for a Nation*, Toronto: McClelland and Stewart, 1965.

⁹³ "Ownership" here is defined as having exploration, extraction and production rights laid out in a series of exploration and production licences or "concessions" overseen and approved by a national/provincial administration and regulatory board styled the Canada-Newfoundland and Labrador Offshore Petroleum Board. The off-shore is actually owned in terms of property title and domain by the Government of Canada as essentially affirmed by a Supreme Court of Canada Reference decision, "the British Columbia Off-shore Reference," November 1967. I accept that this SCC decision on final ownership of the Atlantic off-shore and its implications for NL might be challenged by some or many in the province including successive Premiers and Cabinets.

⁹⁴ Various oil field and corporate websites offer these "ownership" divisions. In Sept. 2013, Statoil and its partner Husky Oil announced a new off-shore oil find in the Flemish Pass Bass, called Bay du Nord oil field, possibly NL's third largest oil discovery. In Nov. 2013, Canadian Finance Minister Jim Flaherty indicated that the Canadian Government would be "open to discussions" on selling its 8.5% stake in the Hibernia field, currently held by the Canada Hibernia Holding Corporation. See Bill Curry, "Tories' \$3.7 billion surplus clears a path for promised tax cuts," *Globe and Mail*, Nov. 12, 2013.

Transaction Costs and Power Relations

On the matter of “transaction costs,” (TCs) using the Loung and Weinthal model, I think we can say TCs are currently high, and thus do not conform with Luong’s and Weinthal’s model on private foreign ownership. Indeed, the NL TCs case seems to be closer to Luong’s and Weinthal’s description of a private domestic ownership pattern. Information asymmetries abound in the relationship between the NL Government, its partner the federal⁹⁵ regulatory authority, the Canada-Newfoundland and Labrador Offshore Petroleum Board (C-NLOPB) on one side, and the consortia of private and state, foreign and domestic oil companies. The oil companies side do not willingly share information with Canada and NL. Enormous information and knowledge uncertainties have been apparent on both sides.⁹⁶ As a result, typically, intense bargaining occurs on both sides, starting with the Hibernia project, particularly between Canada and the oil consortium led by ExxonMobil, right up to 1990. In the wake of this hard bargaining, in 1992 one of the private foreign partners withdrew, Gulf Oil, thus leaving its 25% stake in limbo until a buyer could be found. Later, the same consortium threatened to cancel the Hibernia project given design errors and unacceptable execution on the construction of the off-shore platform. Ottawa helped to resolve the impasse. Since the Province had so laser-focused on job creation benefits issues, NL ended up settling for a comparative low royalty rate (1%/yr up to 5%).⁹⁷ This early “explicit bargaining” obviously left NL on the short end of the contractual stick, and inclined the Province to layer on institutional guidelines and to build up a counter-balancing institutional apparatus.

The Terra Nova project began in late 1995 and was completed in record time, 1998. Terra Nova proceeded on a completely different track from Hibernia. No construction and labour benefits were offered by the oil consortium and effectively none were demanded by NL – and no state subsidies were offered. A floating ship-style platform (FPSO, floating production, storage and off-loading vessel) was

⁹⁵ I use the term “federal” in its original meaning i.e. combined national and provincial state interests and organizations.

⁹⁶ Leah Fusco, “Offshore Oil: An Overview of Development in Newfoundland and Labrador,” Occasional Paper # 2, *Oil, Power and Dependency Project*, led by Peter Sinclair, Memorial University, 2007, pp. 4-5.

⁹⁷ Loc. cit.

constructed by Koreans not Newfoundlanders to serve as the off-shore platform. However, NL achieved a much better royalty rate on Terra Nova; the hard bargaining was reserved for the royalty contract.

By the time the third oil field came on stream, White Rose, all sides had learned key lessons. The information asymmetries so prevalent in the Hibernia project and to a lesser extent in Terra Nova seemed to dissipate. Distrust among the parties and general dissatisfaction in the pre-production phase appeared to be a thing of the past. After the White Rose application was submitted by the oil partnership of Husky Energy (U.S.) and Suncor Energy (Can.) in January 2001, the well-schooled parties on both sides knew precisely what they wanted in the deal. But information symmetry did not entirely yield contractual calm or political quiescence. The NL Government did want more job creation benefits and the use of a “gravity based” extraction platform with resulting construction at the giant Bull Arm fabrication site. This option was much more labour-intensive than the ship-based (FPSO) platform that the consortium favoured for White Rose. While the ship-base platform ended up being adopted, NL did secure a number of add-on construction projects on the island constituting 2.8 million person hours of work. (Previously in June 1996 a new “generic royalty regime” was announced for all oil projects going into the future.⁹⁸) Thus, the contract on royalties drawing in White Rose was thought to be fair and satisfactory to all parties. In general, transactions costs for White Rose seemed to be more reasonable and acceptable to NL.

However, all bets were off by the time the Hebron project emerged. Discovery of the Hebron oil field dated back to 1981, but it was 10 years before negotiations began; another 10 years before a second-round oil developer took an interest in the project, and another five years (2005) before a final consortium of developers emerged. In 2006, the now (in)famous dispute between the oil consortium and Premier Danny Williams took flight. Ten years had come and gone and Danny Williams wanted a renewed and leveraged up royalty regime for the Hebron project, exceeding the “generic royalty regime” agreed to previously. Williams wanted a regime that captured “super-royalties” in times of high oil prices. He also wanted 10% equity stake for the Province, and he wanted a new oil refinery built in NL. In return, the oil

⁹⁸ References in this and the foregoing paragraph are taken from Leah Fusco, pp. 5-9.

consortium demanded up to a half million dollars in tax credits.⁹⁹ Williams soon targeted ExxonMobil, the lead negotiator, for bad faith bargaining, and threatened “fallow field” legislation to disenfranchise any oil partner failing to pursue development of the field on a timely basis. Negotiations soon broke down and broke off. The consortium came back to the table in 2007, and in 2008 an initial agreement was wrapped up with Williams and the Province.¹⁰⁰ Williams achieved his preferred royalty rate, as well as a 5% equity stake in Hebron, but he did not get a new oil refinery – to match the one at Come By Chance built in the early 1970s. Final negotiations dragged on until 2012 including a major dispute over final-phase (third module) construction of the proposed gravity-based off-shore platform. This dispute was lost by the Province as provision for such construction had not been written into the 2008 agreement. And so, political conflict between the parties lasted right through to end of negotiations -- and beyond as “coercive action” was taken by the oil consortium on the platform based on its unilateral power afforded by 2008 “model” contract.

And what did all this hard bargaining, contractual coercion, and intense conflict produce in terms of the Province’s institutional buildup? Essentially NL-based resource institutionalization began with the 1985 Atlantic Accord. The Accord offered the legal authority to Canada and NL to begin building organizations to protect state interests on off-shore oil field developments. The most prominent institutional authority, by far, was the establishment of the C-NLOPB, the federal, administrative, monitoring and regulatory organization jointly run by Canada and NL.¹⁰¹ Joining C-NLOPB in this oversight role were the ministries of natural resources at the provincial and national levels. In addition, C-NLOPB was active in setting up Public Review Commissions – also envisioned by the 1985 Atlantic Accord. These Public Review Commissions were mobilized for the Hibernia, White Rose and Hebron projects. The Commissions formed extensive, expert reviews of the projects’ local benefits plans, their

⁹⁹ Leah Fusco, p. 10.

¹⁰⁰ See also Kimble Ainslie, “Canadian Energy Politics and Canada-U.S. Relations, 1970-2012,” *Geopolitics of Energy*, vol. 34, (Aug. 2012) no. 8, pp. 10-12.

¹⁰¹ In June 2012 C-NLOPB reported a staff complement of 72 persons, and less than a dozen in the management ranks. See C-NLOPB, *Annual Report*, June 2012.

socio-economic and environmental evaluations and a variety of other non-fiscal issues. Legislative enactments also occurred, including Ottawa's 1990 *Hibernia Development Project Act* (S.C. 1990 c. 41).

Societal Expectations

In the negotiations and conflicts that occurred on the development three of the four, off-shore oil fields, job creation and provincial construction projects were benefits regularly identified by elected representatives, Governments of the day, interest groups, labour unions, and to a lesser extent by bureaucrats. To paraphrase the language of Luong and Weinthal, "domestic elites" – political, bureaucratic and labour -- were the principal channels for these expectations. Consistent with the definition offered by Luong and Weinthal in reference private foreign ownership, "societal expectations" i.e. institutional expectations were high. On the ground, actual participation by ordinary citizens tended to be muted and at a low ebb; only indirectly expressed through politicians and unions.

Summary

Luong's and Weinthal's test on the ownership issue is whether a strong, weak or hybrid fiscal regime emerges from the influence of transactions costs, societal expectation and power relations? The pattern expressed in NL reveals high transactions costs and high expectations for local benefits. Explicit bargaining and generally high conflict characterized state-corporate power relations. This pattern predicts a *strong fiscal regime* and so it is with NL, best described as having a moderately strong institutional profile. Curiously this strong regime pattern, according to Luong and Weinthal is emblematic of a private domestic ownership structure, and of course, as we know the NL case reflects a hybrid foreign ownership structure. Do we have an amendment to the Luong and Weinthal analysis? The answer is: probably.

But a more important question is: Did NL suffer from an *institutional curse* as a result of the off-shore projects starting in 1985? My answer is: not really. Even neo-liberals¹⁰² would likely approve of

¹⁰² For a very useful review of neo-liberal positioning see Francis Fukuyama, *State-Building: Governance and World Order in the 21st Century*, Ithaca: Cornell University Press, 2004.

NL's performance, notwithstanding all the rough edges and the steep learning curve inside the state sector. State roles were restricted to monitoring, administrative issues and modest regulatory enforcement. Nationalizations were not part of the historical record, state enterprises were not front-and-centre; redistribution was not the primary ethic. As state institutions go, the NL energy development apparatus appeared to be reasonably effective but limited; moreover, it lacked a public record of corruption and officials demonstrated reasonable competence.

Occasionally, salient errors were made – perhaps underscored with the benefit of hindsight. And yet, inexperience obviously prevailed in establishing such a low royalty rate on Hibernia in mid 1980s. Begging off significant provincial involvement in the development of the Terra Nova field does not seem to be the most apposite stratagem even under circumstances of the day. Missing out on the “third module” development for local construction on the Hebron project also seems – from afar -- to be a startling oversight in 2008. And, off-shore capital surpluses “invested” in Nalcor's Muskrat Falls development is likely going to compound a series of antecedent strategic errors by the Province.

But overall, the primary case evidence for my salutary evaluation, the way NL Governments later in the process – starting with White Rose -- traded off internally-generated demands for high petroleum royalties and at the same time attempted to achieve the highest possible local benefits for residents. Over time, they learned that high royalties and high local benefits could not be simultaneously achieved. Working out which strategic option was best for the times was a difficult and institutionally complex affair, particularly as private sector partners in the oil consortia were very hard-nosed bargainers. The manner in which these compromises over the course of two decades were reached bolsters my observation that NL evinced a reasonably effective, limited, uncorrupt, and competent institutional profile.

Economic Growth, Capital Investment Strategies, and Economic Development

Resource wealth has been a current reality in NL for several years, and will remain so for a minimum of twenty years, but has this wealth had a positive or negative effect on the economy of NL?¹⁰³ I have reviewed the NL's aggregate economic performance data from 2005 to 2012 (8 yr. inclusive). As noted previously, NL's government revenues have been remarkably stable and consistent since full, off-shore oil production has been in play. And in a parallel fashion, provincial annual GDP changes have been nearly exclusively and unilaterally upward since 2005 – the major exception being recession year 2009 when GDP fell by 8.9%. Otherwise an average 3.2% annual GDP growth has been experienced for the other 7 years. Fighting this average was a major bump-up of 7.9% in 2007, and a drop of 0.4% in 2012. The Province expects growth in the 6% range for all of 2013 and 3% in 2014.¹⁰⁴

In addition to steady economic growth, we take special note of NL's labour market numbers. There were regular annual increases in the number employed from 2005 onward and a reduction in the unemployment rate, except for the recession year 2009. Moreover, the province re-established a pattern of net in-migration starting in the mid 2000s, with a population increase – the first in 16 years – starting in 2008. It is easy to surmise why the off-shore oil industry is drawing Newfoundlanders back home after the unsettling loss of the cod fishery in 1992 and net out-migration in its wake. The bad news is the stubbornly high overall unemployment rate across the province since 2005, starting at 15.2%, down to 11.3% in 2013 – figures which are well above national unemployment rates.¹⁰⁵

It is hard to know if there is any “crowding out” of entrepreneurs by the resource sector, since the proportion of self-employed in NL has been the lowest in the nation for quite some time, about 6-7% of

¹⁰³ *Securing the Future*, Figure 12, p. 15.

¹⁰⁴ The foregoing figures are taken from NL's annual publication, *The Economy*, appended to budget documents filed each year.

¹⁰⁵ Government of Newfoundland and Labrador, “Selected Economic Indicators, 2007-2015 (forecast),” sourced from Statistics Canada and Dept. of Finance, NL, “Employment Commentary, May 2013,” June 20, 2013.

total employment; a pattern established well before the off-shore became so important to GDP.¹⁰⁶

Currently (2012), self-employment and thus entrepreneurship has risen to 10.4%, but still below national (15%) and other provincial rates.¹⁰⁷

Overall capital investment in the Province has been moving routinely upward between 2005 and 2012. While NL saw modest investment growth from 2005 to 2009, the trajectory rose steeply starting in 2009, leaping 22%, 25% and 33%, year-over-year, up to 2012. It is likely to drop to 10% growth by the end of 2013.¹⁰⁸ Mining, oil and gas extraction sectors lead this investment profile, at least back to 2009; indeed, about half (49%) of all investment in the province in 2013 occurs in this broadly-defined resource sector (\$5.4 billion).¹⁰⁹ In June 2013, the *Globe and Mail* reported:

The Conference Board cites ... record private sector investment over the next two years including an expansion project by Iron Co. of Canada, Alderon Iron Ore's Kami project, a Vale processing facility, the Hebron gravity-based oil structure [at Bull Arm], and the Muskrat Falls hydroelectric development.¹¹⁰

Manufacturing investment rose to \$1.1 billion in 2011 and \$1.3 billion in 2012; it dropped by half in 2013.¹¹¹ Overall, manufacturing in NL is the poor sister of the economy, about 3% of GDP. Moreover, our findings on Dutch Disease reveal that only a few industries are vulnerable: seafood, newsprint and possibly furniture, but that the effects are modest to marginal.

There appears to be no evidence, in the aggregate, of an “enclave” effect; the province as a whole is benefiting from the petroleum industry in terms of new investment. In other areas of the economy we

¹⁰⁶ Statistics Canada, “Experienced labour force 15 years and over by class of worker, by sex, by province and territory (2006 Census) and David Campbell blog, “Self-Employment Trends Across Canada,” *It's the Economy, Stupid*, Mar. 14, 2012.

¹⁰⁷ Information received from an NL Dept. of Finance official by telephone, Aug. 9, 2013.

¹⁰⁸ *The Economy* series.

¹⁰⁹ Statistics Canada, “Capital Expenditures by Sector, By Province and Territory, Newfoundland and Labrador,” 2013.

¹¹⁰ McKenna, *Globe and Mail*, June 12, 2013.

¹¹¹ Statistics Canada, “Capital Expenditures,” 2013.

observe similar upward trend lines in retail sales and housing starts.¹¹² Moreover, contrary to Richard Auty's somewhat pessimistic analysis of resource-based industrialization (RBI) in developing countries, NL's experience has been modestly successful, but it has taken many years in some cases to capture the rainbow.

Perhaps the longest-lasting RBI initiative is the Come By Chance oil refinery. Built in the early 1970s, Come By Chance went bankrupt in 1976; it was purchased by Petro-Canada in 1980, then a Canadian state enterprise, and it was not re-opened until 1987. Several ownership changes later it is currently owned by the Korean National Oil Corporation, a state enterprise headquartered in South Korea. Come By Chance absorbs about half of the oil produced in the off-shore and so there is a direct link to NL's rentier state in resources. Come By Chance sells about 90% of its refined product from crude oil to the United States, and about 10% to NL.¹¹³

Next, the Bull Arm industrial fabrication complex -- built in the early 1990s to construct the massive gravity-based off-shore oil platform for Hibernia -- started off as a star for the province, but petered out after Hibernia's construction finished. Some work was obtained for the Terra Nova and White Rose ship-based (FPSO) platforms, but considerably less than the site's intended capacity. Its fortunes were resurrected with the gravity-based Hebron platform, but even here the third module work will be transferred out of the country.¹¹⁴ In addition to Bull Arm, the province has other fabrication plants assisting the resource sector including: Cow Head, C&W Fabrication, Newdock *et cetera*.

¹¹² *The Economy* series.

¹¹³ Alan Parker, "How Oil Makes Canada Four (or Five) Different Countries," *Toronto Sun*, Mar. 10, 2011. In mid 2013, the NL Minister of Natural Resources acknowledged the possible sale of the Come By Chance refinery and even possible closure. Its South Korean owners had been losing money in 2012 and 2013, up to \$106 million in the first six months of 2013. See Shawn Hayward, "Refinery future in limbo," *The Packet*, (Clareville, NL) Nov. 13, 2013.

¹¹⁴ Bull Arm is currently owned by the NL state enterprise, Nalcor.

Beyond oil, Vale NL started construction of its Long Harbour nickel processing facility in 2009; a \$2 billion project where phase 1 construction was completed on October 30, 2013. Nickel production is expected to begin in 2014, and the plant will employ about 500 technicians.¹¹⁵

And so in a province with a tiny manufacturing sector, RBI in the province has been reasonably impressive. Just like Blackberry has been responsible for dozens of spin-offs firms in Southwestern Ontario, so too is off-shore petroleum extraction contributing significant industrialization in NL – in a province we need to remember that has a population of a half million residents, and until 1992 a province still tied to the fishing industry.

And finally, NL Governments since 1997 have declined to entertain the idea of saving a portion of the Province’s annual resource revenues in a “natural resources fund” or a “heritage savings trust fund” as Albertans refer to it. Most rents from the off-shore go to provincial operating expenditures and some are likely siphoned off to big projects like Muskrat Falls. Apart from whatever economic spin-offs are spent in the present that might last into the future, most resource rents are being exhausted for short-term purposes.

Democratic Accountability

Unlike many developing nations where resource abundance is found, Newfoundland has a long-established tradition of popular, representative government. Apart from the Commission period (1934-49) in pre-Confederation times, folks on the island and Labrador have experienced decades of elected legislatures and reasonably responsible executives.

On the matter of governance under conditions of resource abundance, the institutional aspects of NL’s democracy are well entrenched and almost as well developed as the most politically developed elsewhere in Canada on matter of oversight and accountability. For example, during the period of mobilizing the off-shore, essentially since the signing of the 1985 Atlantic Accord, the federal,

¹¹⁵ Deana Stokes Sullivan, “NL: Major layoff at Long Harbour Vale processing plant,” *The Telegram*, Nov. 8, 2013.

comprehensively mandated C-NLOPB has been a very active player in overseeing resource planning, administration and regulation. C-NLOPB has been considerably assisted in its reviews by a series of Public Review Commissions for the Hibernia project as well as White Rose and Hebron. In the early 1980s, moreover, major environmental and economic impact assessments of the off-shore were commissioned, including by the Government of Canada. In 2007, the Province published its *Energy Plan*, a planning document that contemplated broad energy development for years in the future. There have also been thoroughgoing reviews of the oil consortia's development plans and benefit plans along the way by various public bodies. Thus, from an institutional point of view, there have been a lot of players, lots of commentary, and lots of penetrating analysis; the guardians on the wall have been vigilant.¹¹⁶

By comparison, there appears to be considerably less participation in resource discourses by ordinary citizens of the province – excluding interest groups, lobby groups and unions. While it is true that public interest in resource development was high in the early days of Hibernia that interest has waned over the years. As noted previously, in the place of any volume or complexity of public debate, two simple public demands are usually present: “jobs for the folks” and low taxation. “Jobs for the folks” has been the perennial call since Hibernia, and is always closely attended to by politicians and official budget writers.¹¹⁷ And somewhat surprisingly when it comes to energy developments, the folks do not want much of their skin in the game; little personal sacrifice is approved of in the form of taxes. Early on in a pre-budget consultation exercise in the winter of 1997, citizens in a government survey were asked about a number of issues including increased taxation.¹¹⁸ Close to two-thirds said they “strongly disagreed” with higher taxation even if it meant only “small increases” in spending over a number of program areas.¹¹⁹ On

¹¹⁶ A really quite salient feature of NL governance over the resource sector and general government for that matter is the government's high orientation toward transparency. Basic information and data searches on NL resource economy are easily obtained and carried out. Public servants in the Finance Department return phone calls quickly and efficiently. The transparency issue is, of course, a major concern for rentier states in less developed countries, leading to charges of corruption and all manner of criminality. Happily, NL suffers from none of these indignities.

¹¹⁷ Leah Fusco, “Offshore Oil,” 2007.

¹¹⁸ For a remarkably strong treatment of this issue see Leah Fusco's master's thesis at Memorial University, October 2007, “The Invisible Movement: The Response of the Newfoundland Environmental Movement to the Offshore Oil Industry.”

¹¹⁹ NL. *Budget*, 1997.

an ongoing basis, few members of any electorate across Canada demand higher taxes; on the other hand, taxpayers in NL are quite insistent on government-financed jobs and other state largess. Recently, a union-sponsored public opinion survey by Harris-Decima Research (N=503, Apr. 22-May 5, 2013) indicated a 71% rejection of program and service cuts emanating from the 2013 NL Budget.

And on a related point, which I previously underscored referencing Terry Lynn Karl and Paul Collier, citizen involvement in the governance of rentier states is tamped down and sometimes stamped out by the absence of a collective commitment by citizens to pay for the “investments,” services and programs they demand from rentier states. Low personal income taxation in rentier states leads to low public participation. NL faces this danger as well. Regularly in NL budgets individual taxpayers are asked to pay only on average 13% of annual expenses. As we know, about 31% of revenues come from resources, almost all from the off-shore. (By comparison, the individual taxation share in the province of Saskatchewan (2012-13 budget) is about 20%, notwithstanding the fact that Saskatchewan is also a rentier state and has been for a long time.¹²⁰) We get a taste of NL’s low public participation in 2010, when requests for public comment on development of the new Hibernia South oil field by C-NLOPB netted only three submissions.¹²¹ A C-NLOPB official commented to the news media: “We don’t get a tremendous response to these consultations. We do get *some* comments, and of course, we’ll incorporate those comments into the staff analysis”¹²² This lethargic public response is by no means atypical. Indeed, a case can be made that low participation rates are part of the fobbing off process that is directly the result of public demand for lowering taxation and the reality of low individual taxation rates in NL budgets.

¹²⁰ Government of Saskatchewan, *Budget 2013-14*, p. 38; Richards and Pratt, *Prairie Capitalism*, chapter 8. Saskatchewan has also produced a series of balance budgets since the recession even though an average 68% of annual expenditures are taken up in social spending (education, health and welfare). The province has low debt servicing charges, 3% of annual revenues, and it has an unemployment rate of 4.5%, the lowest in Canada. An average of 25% of annual government revenues comes from the resource sector: oil and potash, and an average 34% of GDP from 2007-2011 is produced by the resource sector.

¹²¹ Moira Baird, “Hibernia South draws few comments,” *The (St. John’s) Telegram*, June 12, 2010.

¹²² Moira Baird, June 12, 2010.

Summary Observations

What do we have after this lengthy discussion of Dutch Disease and a possible resource curse in NL? I have concluded that Dutch Disease effects are likely marginal and perhaps imperceptible. The main reason is the NL manufacturing sector is tiny, and the effects on this tiny sector are probably too small to measure. The two research teams chosen to evaluate Dutch Disease agree only on one industry amongst many that might suffer from the “disease,” and that is furniture manufacturers, and only those who export. I have canvassed directories for firms that might export out of the province; this search revealed perhaps one company. There is effectively no Dutch Disease problem in NL.

On the resource curse, while NL is emphatically identified as a rentier state and is likely resource dependent with all the vulnerabilities that these conditions entail, its performance score-card is mixed; there are some positives, some negatives and some ambiguous areas. The principal problem lies on the fiscal management side of state performance, and on an issue Jereoen Kremers warned us about: consumption/public spending by government. We have successive Governments in NL that can best be described as recidivist spenders. Almost every nickel deposited into the NL treasury from the off-shore is ear-marked for short-term spending or lending (e.g. Muskrat Falls). From time to time, Governments rein in the profligate spending, resorting to austerity programs, which last for a couple of years. But then, old bad habits reappear, rationalized by rhetorical symbols such as: “infrastructure deficits,” the need to “catch up” or “we’ve been suffering for years and we deserve it.”

I am asserting that the over-spending problem is my central finding. Yet it is not entirely a straightforward assertion. To the extent there is a long-term pattern of over-spending NL, even profligate spending, its origins are found, in part, in political and bureaucratic norms established during the period when equalization payments were prominent. This was a period when the Government of Canada cash came in and was shortly spent, because the same kind of cash was available next year, and the year after that. On the social spending envelope, for example, there was nary a hiccup in the transition from high

spending financed by equalization and high spending financed by resource rents during the 2000s. But, the problem of entrenched spending norms cannot be laid exclusively at the feet of NL's political class and bureaucracy, since so much of the pressure to spend equalization money came from the province's political culture, and deeply entrenched public expectations to cash in on short-term advantage – the effect of “hyperbolic discounting” referenced previously. And so, I am hard-pressed to argue that offshore oil is *causing* a resource curse *qua* spending problem in the province. What is clear is the continuing contribution that oil rents are making to conditions mimicking a resource curse in the post-equalization period. Oil revenues are currently feeding the resource curse spending habit in NL, even as the habit became entrenched years before.

Perhaps the most enervating outcome on the spending side is the failure to consider a provincial savings fund in order to assure future fiscal stability when the oil runs out.¹²³ Indeed, there does not appear to be any serious debate on the prospect of a natural resource fund to salt away surplus revenues -- assuming the concept of “surplus” revenues is appreciated by state elites. Premier Dunderdale has dismissed the concept out of hand with a rebuttal suggesting “investing in infrastructure is our saving plan.”¹²⁴

Finally, on the resource curse, there, of course, has been quite a lot of discussion on the ill-effects of resource abundance for democracy. One notable American commentator, Thomas Friedman, of the *New York Times* has gone so far as to suggest there is a First Law of Petropolitics: “the price of oil and the pace of freedom always move in opposite directions in oil-rich petrolist states.”¹²⁵ The results for NL are not so clear-cut. NL elite and institutional capacity has certainly not been undone by resource abundance; however, there is evidence that NL citizen involvement with public affairs has not been significantly mobilized and perhaps the opposite has occurred. Popular participation in affairs of resource governance historically has been mainly at a low-ebb and it remains there. Resource wealth has not

¹²³ See Madelaine Drohan, “Spending Like There’s No Tomorrow,” *Literary Review of Canada*, Jan.-Feb. 2013.

¹²⁴ See Steve Bartlett, “Premier, economist differ on legacy fund concept,” *The (St. John’s) Telegram*, June 29, 2011.

¹²⁵ Thomas Friedman, “The First Law of Petropolitics,” *Foreign Policy* magazine, May 1, 2006.

significantly heightened interest in energy issues, and there is a case to be made that it has led to a quiescent population, lulled to sleep by growing job prospects, rising salaries, and the fear of losing them. Leah Fusco's marvellous master's thesis at Memorial University makes plain this problem in reference to environmental mobilization.

Even as Jeffrey Sachs and many other academic notables have made the case that economic growth suffers under resource abundance and related rentier conditions, NL appears to be fighting this outcome. As rents improve, so too does NL's GDP. Indeed, it has never been clear to me why we would see a different result, absent kleptocracy, corruption, enclave effects, and antecedent state failure. When the rents start to peter out in 20 years, then NL will be much weakened in the absence of replacement economic benefits coming from Labrador's Churchill River hydroelectric projects. (On the latter, NL will not be entirely out of the woods until 2041 when the Upper Churchill contract with Hydro Quebec comes to an end.) But for now, economic growth is not generally negatively affected by resource abundance.

Capital investment and RBI initiatives face difficult prospects at the best of times, and yet overall RBI results have been positive for the NL economy. Manufacturing investment is more than a bit uneven, but a promotional demeanour and astonishing determination by succeeding generations of state elites have made perseverance on private sector resource-based industrial expansion its own constructive reward. That the Come By Chance oil refinery has survived for just over 40 years is a testament to this perseverance – even if recent events call that positive history into question. The facility at Bull Arm and the smaller private facilities including Cow Head, C&W Fabrication and Newdock have also made contributions, although as unevenly as Come By Chance. And, while Muskrat Falls is likely going to be a very significant challenge, once the legal wrangling, intergovernmental negotiations, economics and financing are settled, if history is our guide, this project too will proceed within the economic and state capacity limitations of the province. Moreover, as an adjunct to the petroleum sector, the most positive outcome in years comes by way of Vale NL's recently constructed Long Harbour nickel processing facility.

Further on the positives, it is hard to deny the generally effective performance of state segments in monitoring, administering and regulating the off-shore, with special reference to the performance of C-NLOPB. (It also strikes me that the presence of the Government of Canada as a partner in C-NLOPB is not entirely a draw-back, notwithstanding likely contrary sentiments residing inside the Government of NL and elsewhere across the province. I am inclined to think that the Ottawa's institutional prominence benefits the province when negotiating with and managing relations with various international oil companies, specifically American multinationals.) On the institutional management of the off-shore, I see no state over-reach, a strong but limited state role, effective performance, and a mobilizing state apparatus in terms of public participation – even if such efforts are not regularly rewarded. I see no institutional curse.