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Do the recent moves by the government to encourage prospecting and exploration of the mineral estate risk turning NZ into the Nigeria of the South Pacific?

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By Jason Krupp*

The resource estate is a controversial economic topic in New Zealand.

The government has made significant strides in developing a regulatory framework to encourage extraction, but this flies in the face of vocal opposition from various groups.

With an estimated onshore value of $200 billion, and potentially the same offshore if another major oil and gas discovery is made, it is easy to see why the government is eager to ramp up the mineral sector's contribution to the economy.

Yet one of the strongest rational arguments against mineral extraction, beside the environmental impacts, is that it would invite the resource curse.

This is the phenomenon where countries with great mineral wealth, or who go through a minerals boom, seem to perform worse economically than their resource-poor peers.

The common sense proof of this can be seen in the Arab world, where the gross national income per capita was US$7,167 in 2012, whereas it is was almost five times higher in the Euro Zone despite vast disparity in mineral wealth.

So will New Zealand risk becoming an Iran or a Saudi Arabia if we strike a big oil and gas find or rapidly upscale onshore mineral extraction?

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There is certainly evidence to suggest that the mineral curse does exist, which has been well researched in economics, although it comes in different forms.

There is the Dutch Disease, where high wages on the back of a mineral boom suck skilled workers out of the manufacturing and agricultural sectors, and the resulting influx of commodity earnings drives up the value of the domestic currency.

Countries reliant on minerals exports are also likely to experience declining terms of trade, having to export an ever greater number of natural resources to acquire a fixed basket of imported goods due to the competitive nature of commodity markets.

The volatility of commodity markets themselves are thought to make economic planning difficult, and can create fluctuations in tax revenues and the domestic currency as prices swing with demand cycles.

Lastly, the more dependent an economy is on minerals as a share of GDP, the more likely it is to encourage rent seeking behaviour (or lobbying for political favour), which may ultimately be to the detriment of other productive sectors in society. Similarly, conflicts over the distribution of mineral profits may also promote corruption, civil unrest, and wars.

If you buy into this reasoning it would be better to leave the gold in the ground, which is what many anti-mining and environmental groups advocate. Indeed Greens MP Catherine Delahunty has damned mining a boom-and-bust industry.

Fortunately debate is more complicated than this. Recent research suggests that minerals are not the curse they appear to be, otherwise countries like Australia, Canada, Finland, and Norway would linger at the bottom of the economic development league tables instead of near the top, where they are now.

Some now think that it is the quality of institutions which determine whether a country with a large mineral endowment will incur the resource curse.

Economist Peter Kaznacheev uses the Fraser Institute's Economic Freedom of the World (EFW) Index as a measure of institutional quality. This is based on five factors, namely rule of law and property rights; size of government and taxation; soundness of money; trade regulation and tariffs; and regulation of business, labour and capital markets.

Looking at the **latest EFW ranking** [4] it is immediately clear that a large mineral endowment does not consign you the economic scrap heap, with resource rich countries like Australia, Canada, Chile, Malaysia and Norway all featuring in the top quartile for institutional quality. These countries also featured in the top quartile of the United Nation's Human Development Index for the most part, with Malaysia falling into the second quartile.

On the other end of the EWF ranking were countries like Zimbabwe, Chad, Angola, Burundi and Nigeria - all rich in resources but ranked among the lowest in the world for institutional quality and economic and social development.

This may suggest that a better way of rephrasing the problem is as an institutional curse, namely that countries with weak institutions are likely to produce less than desirable economic and social outcomes regardless of resource endowment. Cape Verde, for example, is a tiny archipelago lacking any significant resources, and is ranked 121st on the EFW Index and 123rd on the Human Development Index.

So why do institutions matter?

It is not because countries like Canada and Norway do not face some of the forces described above. They certainly do, but the research suggests that the quality of their institutions allows their economies to be flexible and efficient enough to cope with these pressures.

The good news for New Zealand is twofold.

First, the mineral estate makes a comparatively minor contribution to GDP, one or two percent in any given year, and output would need to be ramped up significantly to incur some of the resource curse effects, which start when extractive industries account for around 25 percent of GDP.

Second, even if this were the case, New Zealand ranks among the best in the world for institutional quality across a number of measures, such as the EFW (3rd), the World Bank's Doing Business Index (3rd), and the World Economic Forum's Global Competitiveness Index (17th).

Overall, this would suggest that New Zealand is well placed to handle a greater contribution from the minerals sector without turning into a Nigeria.

The controversial environmental side of the mining equation still hangs out there, but here quality of institutional and regulatory structure have a significant role to play, as have changing technologies and business models among miners.

It seems the only real obstacle left is the perception of mining as an industry that only brings costs to local communities and leaves nothing behind besides a giant hole in the ground. And this too can be addressed with policy, but the discussion on incentives in the mining sector must be left for another article.

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