Does governance matter for resource investment?

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Overview

- Geology is not sufficient: differences in governance matters for resource investment
- It can matter a lot:
  - Can delay discovery by more than a decade
  - Can reduce revenues by $200m/year
  - Improving governance might increase (known) national wealth

Where are the resources?

- Rich countries seem to have more of the subsoil assets.
- Are they rich ***because*** of this?
- Is sub-Saharan Africa simply ***resource poor***?

Region	Known subsoil assets/km^2 (in US$)
World	105,000
OECD (club of rich countries)	114,000
Sub-Saharan Africa	**23,000**
South Asia	53,000
Latin America	95,000
Middle East and North Africa	361,000
East Asia & Pacific	77,000
Europe and Central Asia	93,000

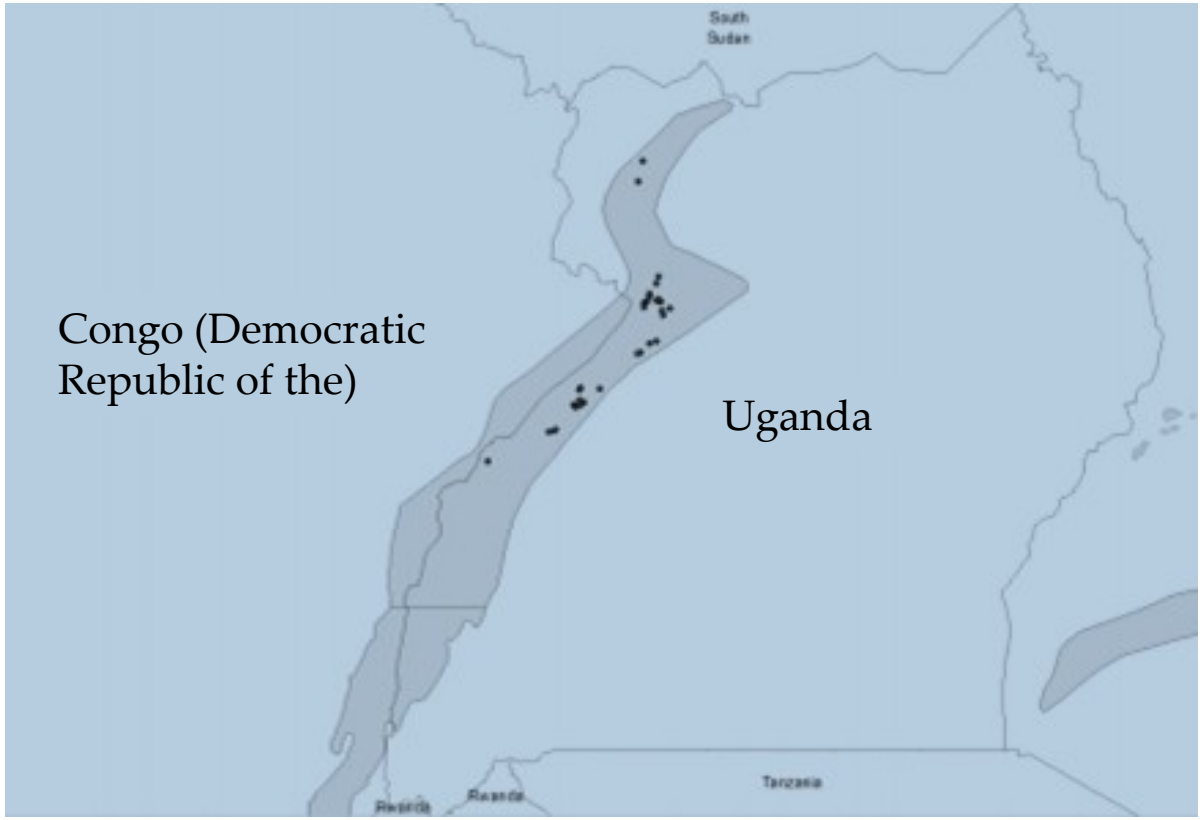
Source: The Changing Wealth of Nations, World Bank, 2006, Collier and Hoeffler calculations, 2011

Does governance drive investment?

- Geology is necessary
- It also seems to be sufficient in some cases: Angola, Venezuela, Nigeria, Arctic exploration
- However:
  - Resource investment is capital-intensive, long-term and with high upfront costs
  - Investors respond to incentives and discount the future (e.g. expropriation risk, stability

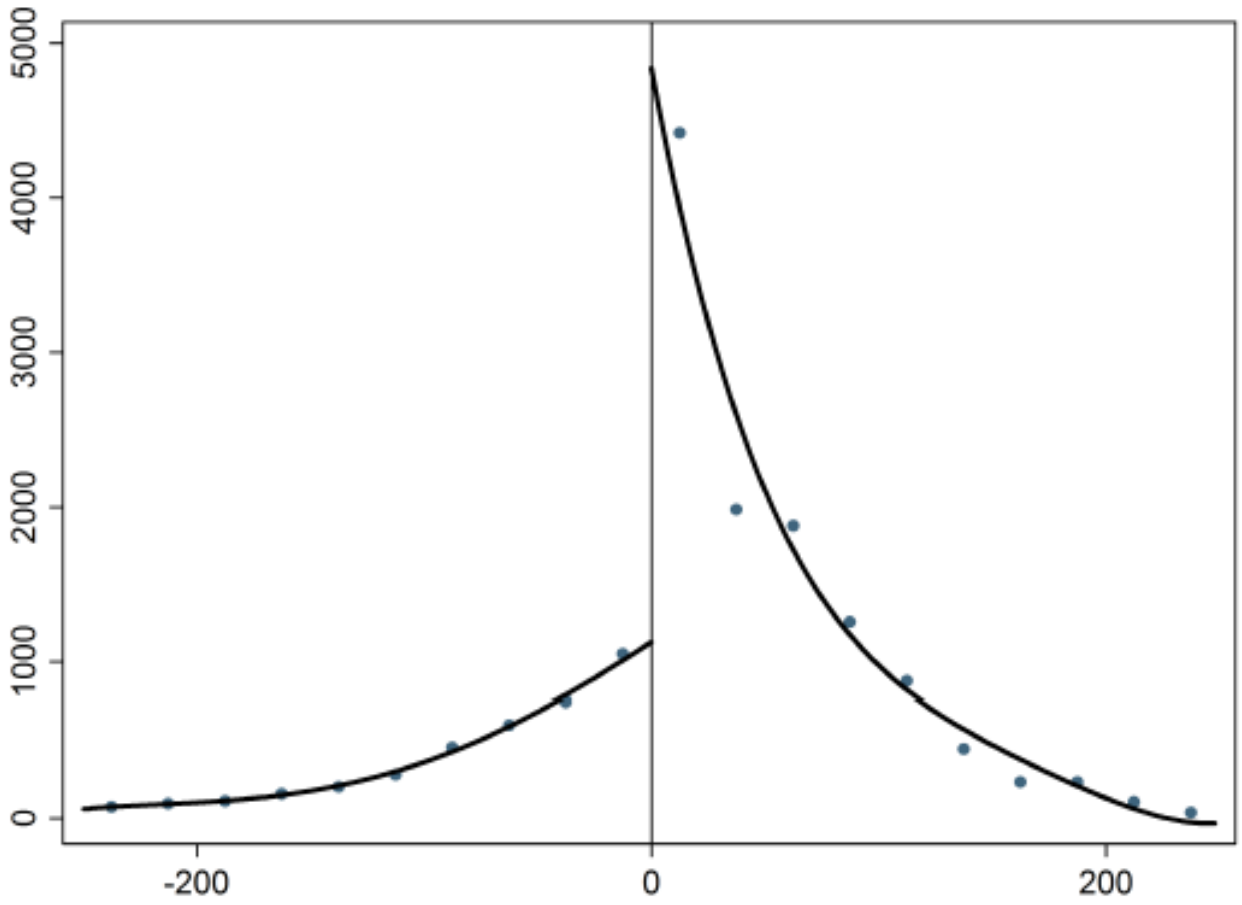
Four pictures to convince you

Drilling close to borders is revealing



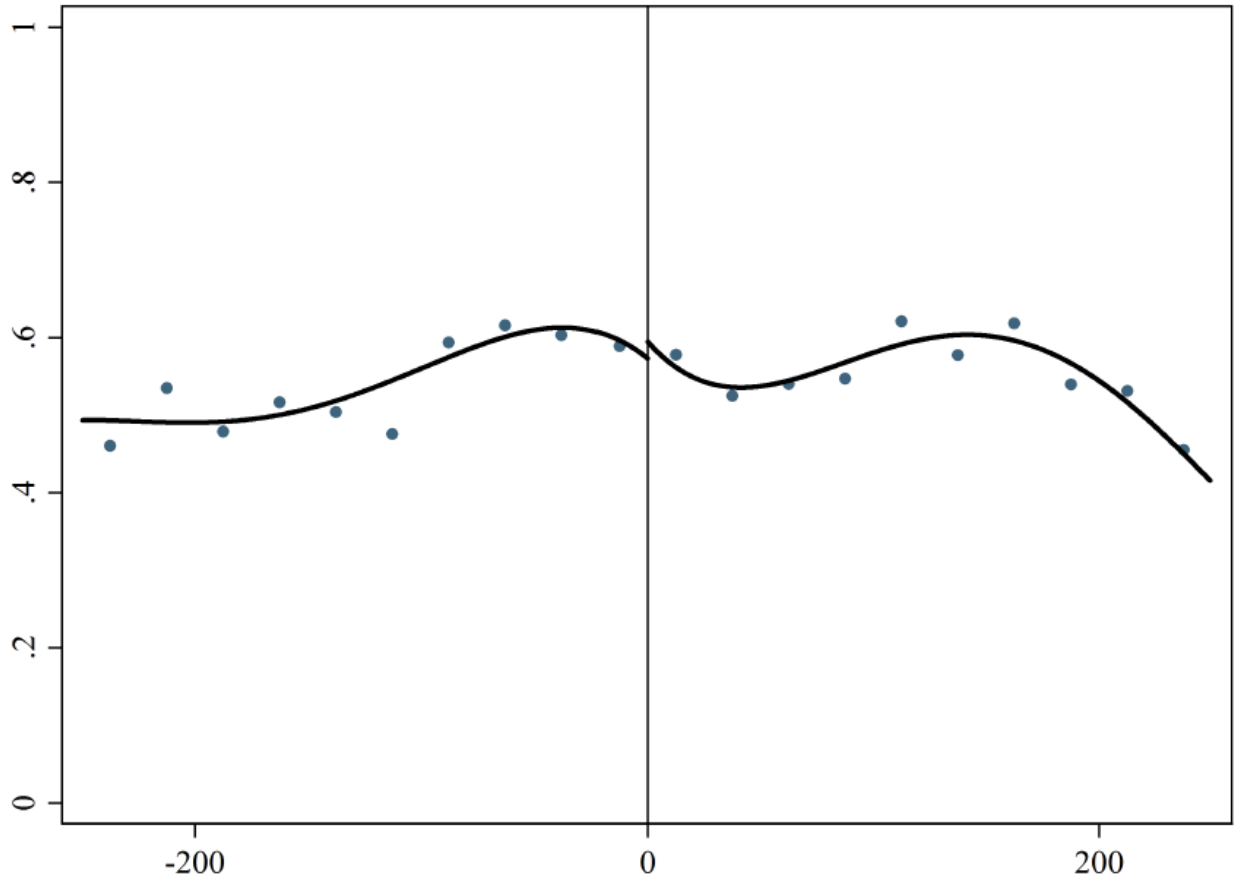
Source: James Cust and Torfinn Harding, 2015 "Institutions and the Location of Oil Exploration", OxCarre Research Paper 127

More drilling on the 'better governed' side of the border



- Number of wells drilled in developing countries (RHS better institutions)

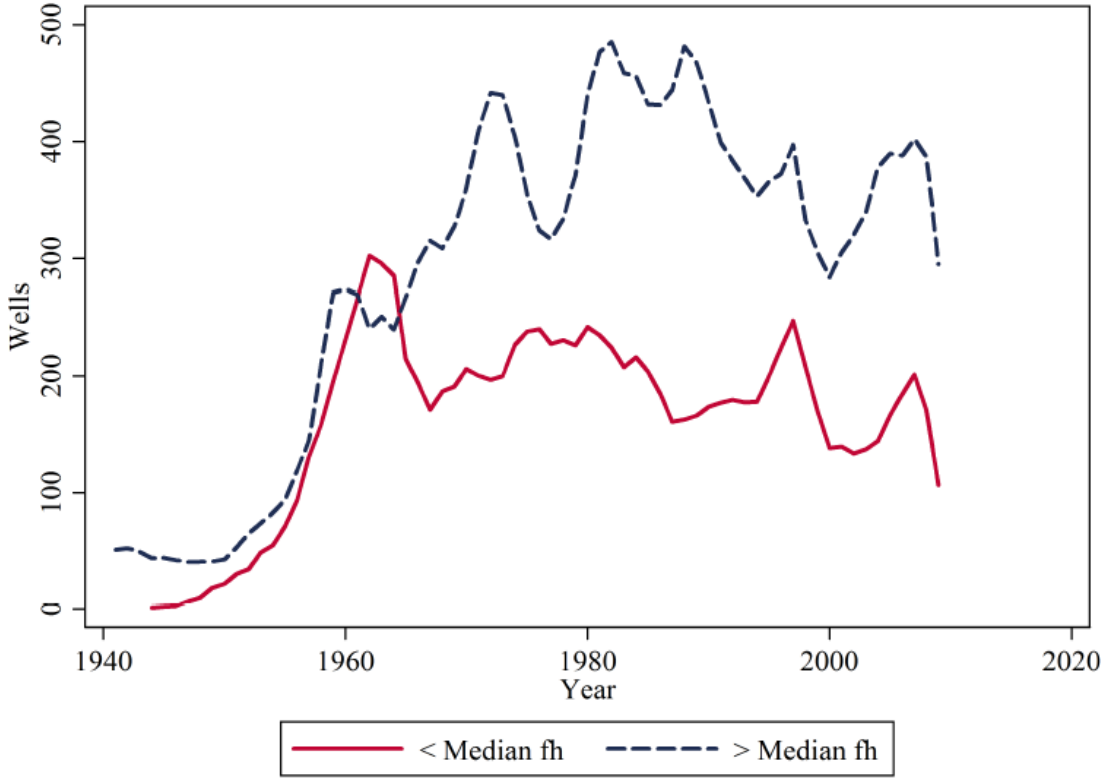
But not more discovery per well….



- Share of dry wells (onshore) (RHS better institutions)

The historic global pattern supports this

Moving average of drilling in developing countries, above vs below median democracy score:



What kind of governance matters?

Broad political rights	Democracy	Autocracy	Constraints on the executive
+	+	--	++

Who cares about governance?

IOCs	NOCs	NOCs at home	Small and mid cap
++	+	+	-

Conclusions

- Governance matters
- It seems to matter a lot:
  - Can delay discovery by more than a decade
  - Can reduce revenues by $200m/year
  - Improving governance might increase (known) national wealth
  - Results do not hold for developed countries
- Some investors seem to be more responsive to governance (IOCs for example)
- Actions to improve governance may be able to increase government revenues and national wealth