Does governance matter for resource investment?

Jim Cust, Director of Research and Data, NRGI & OxCarre
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 \textit{because} of this?
• Is sub-Saharan Africa simply \textit{resource poor}?

<table>
<thead>
<tr>
<th>Region</th>
<th>Known subsoil assets $/km^2$ (in US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>105,000</td>
</tr>
<tr>
<td>OECD (club of rich countries)</td>
<td>114,000</td>
</tr>
<tr>
<td><strong>Sub-Saharan Africa</strong></td>
<td><strong>23,000</strong></td>
</tr>
<tr>
<td>South Asia</td>
<td>53,000</td>
</tr>
<tr>
<td>Latin America</td>
<td>95,000</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>361,000</td>
</tr>
<tr>
<td>East Asia &amp; Pacific</td>
<td>77,000</td>
</tr>
<tr>
<td>Europe and Central Asia</td>
<td>93,000</td>
</tr>
</tbody>
</table>

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?

<table>
<thead>
<tr>
<th>Broad political rights</th>
<th>Democracy</th>
<th>Autocracy</th>
<th>Constraints on the executive</th>
</tr>
</thead>
<tbody>
<tr>
<td>+</td>
<td>+</td>
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</table>
Who cares about governance?

<table>
<thead>
<tr>
<th>IOCs</th>
<th>NOCs</th>
<th>NOCs at home</th>
<th>Small and mid cap</th>
</tr>
</thead>
<tbody>
<tr>
<td>++</td>
<td>+</td>
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</tbody>
</table>
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