Are natural resources a blessing or a curse for developing countries?

The idea of a natural resource curse first arose during the inter-war period, on the observation that resource rich Latin American countries had become victims of a global commodity price slump, with weak growth despite their natural resource endowment. The concept is essentially a situation in which resource rich developing countries suffer weaker economic development due to their abundant resources.

Empirical evidence for this phenomenon is robust. Studies such as Doppelhoffer et al (2000) indicate that there is a strong relation; no countries with high levels of resource export grew quickly between 1970 and 1990. The only (weak) exceptions to this are Iceland, Malaysia and Mauritius.

![Graph showing the relationship between exports of natural resources and real GDP growth per capita (1970-1990)](image)

There are a variety of explanations for this connection, and the relation between natural resources and growth may indeed be a combination of these various factors. Chief among the cited problems of natural resource wealth is its adverse effect on the quality of government and on political economy. The first channel of this is its impact on corruption. Resources such as oil provide a huge supply of fungible money that can easily be stolen by corrupt elites. One need only look to Nigeria, Angola or Venezuela (all of which ranked in the bottom thirty worldwide in the 2012 Transparency Index) to see casual evidence of this link. Indeed, this observation again has empirical basis; a study by economist Pedro Vicente found “clear evidence of a political resource curse” when comparing the tiny West African nation of San Tome
and Principle (which discovered large oil reserves in 1999) and the control Cape Verde, with a “clear pattern of change whereby sectors of primary importance to the political elite of the country saw the clearest increases in corruption”. The main areas of corruption were found to be vote buying, in education and in customs. Indeed, the level of corruption in the allocation of scholarship funds in education was recorded to have risen by between 31 and 40%. In this way, natural resource wealth serves to undermine crucial political institutions, as well as to hamper progress towards established democracy and more effective international trade, thus posing a large barrier to internal and foreign investment, enterprise and economic development in general.

The second problem natural resource wealth can pose for the political economy of developing countries is the problem of taxation. Dambisa Moyo, in her book ‘Dead Aid’ refers to this problem as ‘no representation without taxation’ (in the context of aid). This entails a situation in which the government, funded by natural resource wealth rather than taxing its citizens, has little incentive to act in their interests. This is in essence a case of the principal agent problem. This can undermine both the process of institutional reform, and moves towards democratisation. Though empirical studies provide no clear link between democracy and growth, many economists such as Amartya Sen have held that political and economic freedom are beneficial for growth. The lack of such freedoms in oil rich absolute monarchies such as Oman, the UAE or Saudi Arabia, all of which are described as “Not Free” by the think tank Freedom House, may in part be due to their lack of income tax, and the resultant unaccountability of government to its citizens. To take a non-Arab, non-monarchical example, Venezuela provides ample evidence of the erosive effects of oil wealth on government effectiveness. The quality of Venezuelan regulation ranks in the bottom 4% worldwide according to the World Bank, whilst the regional average was 45%. General government effectiveness was also far behind the rest of Latin America, with Venezuela ranking in the bottom 19% and the region as a whole at 50%.
The final political aspect of the natural resource curse is the ability of such resources to create and perpetuate conflicts within developing nations. This is often, and most obviously manifested in, the form of civil wars. Rebel and separatist groups fighting to control a certain resource or resource rich area can undermine the effectiveness of government in these areas, as well as thus inhibiting the function of essential economic institutions. The instability arising from such conflicts serves to prevent investment both by the government and by firms, as well as hugely harming the growth of non-primary industries. The link between natural resource levels finds a strong empirical basis; Collier (2003) notes that a developing country with primary exports as more than 25% of GDP has a 33% risk of conflict, whilst one in which primary exports constitute around 5% of GDP has an only 6% chance of conflict. The modern world abounds with examples of this. The rise of M23 rebels around Kisingani in the Democratic Republic of the Congo has been inextricably linked with the rivalry of local groups and the government for control of resources such as coal tan and molybdenum.

A purely economic aspect of this resource curse is the problem of 'Dutch Disease'. This phenomenon is where export revenues from natural resources lead to an appreciation of the country’s real exchange rate and inflated wage levels, damaging the development of the country’s manufacturing sector by making such exports less competitive and foreign imports more favourable. This can result in weaker employment, slower productivity growth (as it is the manufacturing sector that experiences this most rapidly) and an unfavourable balance of trade, with negative impacts on the country’s development prospects. Chavez’s Venezuela is a clear example of this. Nominally, oil exports have grown by 410% since 1998, whilst imports have increased by only 130%. In real terms, however, exports have decreased by 40% whilst imports have increased by more than 200%. Venezuela is in many ways a case study of the natural resource curse; since 1998 the country has grown by an average of 2.3% per year (including 5 years of negative growth) whilst the regional average was 3.2%.

A final but multifaceted problem of natural resource wealth for developing countries is the problem of primary industry dependence. This is manifested primarily in a lack of diversification, which is caused both by over emphasis on these industries by the government (as they are highly profitable in the short term), and due to the fact that these industries often out compete others in the country, hindering the process of diversification. This is compounded by the fact that lucrative natural resource extraction often tends to attract the most skilled work in these countries, depriving the manufacturing and services sectors of adequately skilled labour. This problem is compounded by the fact that the natural resources on which they are dependent are generally highly volatile sources of revenue. Foreign oil companies take much of this revenue in profits. In Angola, where oil and diamonds comprised 99.3% of exports in 2005, would likely suffer in the case of a worldwide oil or diamond price slump. As well as damaging institutional and infrastructural development due to the lack of a reliable source of revenue, this can lead to the accumulation of high levels of debts as
governments anticipate high future revenues that fail to be realised. This is made even more problematic if the countries exchange rate depreciates due to a slump in the prices of these resources, as the debt essentially grows larger. Between 1998 and 2010 Venezuelan national debt grew from $31.8 billion to $96 billion, making the nation a net debtor.

It is likely that the natural resource curse is a combination of a variety of these factors, which are indeed mutually exacerbating (take the example of Dutch Disease’s effect on foreign debt obligations). However, it is not true that natural resources always constitute a curse for developing nations. Norway, now the world’s most developed nation (in terms of HDI), is the most widely cited example of this. Norway discovered oil in 1969, and began extraction in 1971. At this point, it was behind many of its Scandinavian counterparts in terms of GDP per capita, at a level of $7000 in 1960. Following the discovery of oil, however, Norway rapidly overtook its Danish and Swedish counterparts. Crucially, it managed to avoid the problem of Dutch Disease. The growth trend of the country is displayed below.

Several things differentiate 1970’s Norway from today’s Nigeria or Venezuela. The first is that Norway at this point was an established and fully-fledged democracy, which likely made it much less susceptible to the kind of corruption and ‘rentier state’ tendencies that tend to undermine governments in developing nations today. The second is that the Norwegian government ensured it maintained adequate control of its resources, with large shares in oil companies such as Statoil (of which it owns 62%) and by strictly controlling the process of licensing and exploration. Finally, the Norwegian government
created a fund from its ownership of reserves and from licensing and extraction revenues that it invests in international financial markets. This has provided the country with an invaluable cushion of financial assets with which to mitigate the effects of changes in oil prices and the global economic climate.

Sadly, the Norwegian experience is extremely difficult for many resource rich developing countries to replicate. In this respect, the resource curse appears primarily to be a political problem. Weak and ineffective governments are much more likely to succumb to the political effects of resource wealth, meaning that they can easily spiral into complete ineffectiveness (as in the DRC, for instance). The formation of robust institutions and a transparent political system appears to be crucial in preventing developing countries from sliding into the natural resource trap.