ECONOMICS OF LESS DEVELOPED COUNTRIES

EC3141
Spring 2020

Case Study 2

Michael King

The Resource Curse

Initial observations:

1. No overlap in the countries that have large natural resource endowments and those with high levels of GDP (see graph).
2. Extremely resource abundant countries have not experienced sustained rapid economic growth (e.g. Nigeria, Mexico, Venezuela)
3. Resource-abundant countries tended to be high-price economies and, perhaps as a consequence, these countries tended to miss-out on export-led growth (Sachs & Warner, 2001)

- High resource intensity correlated with slow growth, even when other variables are controlled for (Sachs & Warner, 2001).

Sachs and Warner (2001)

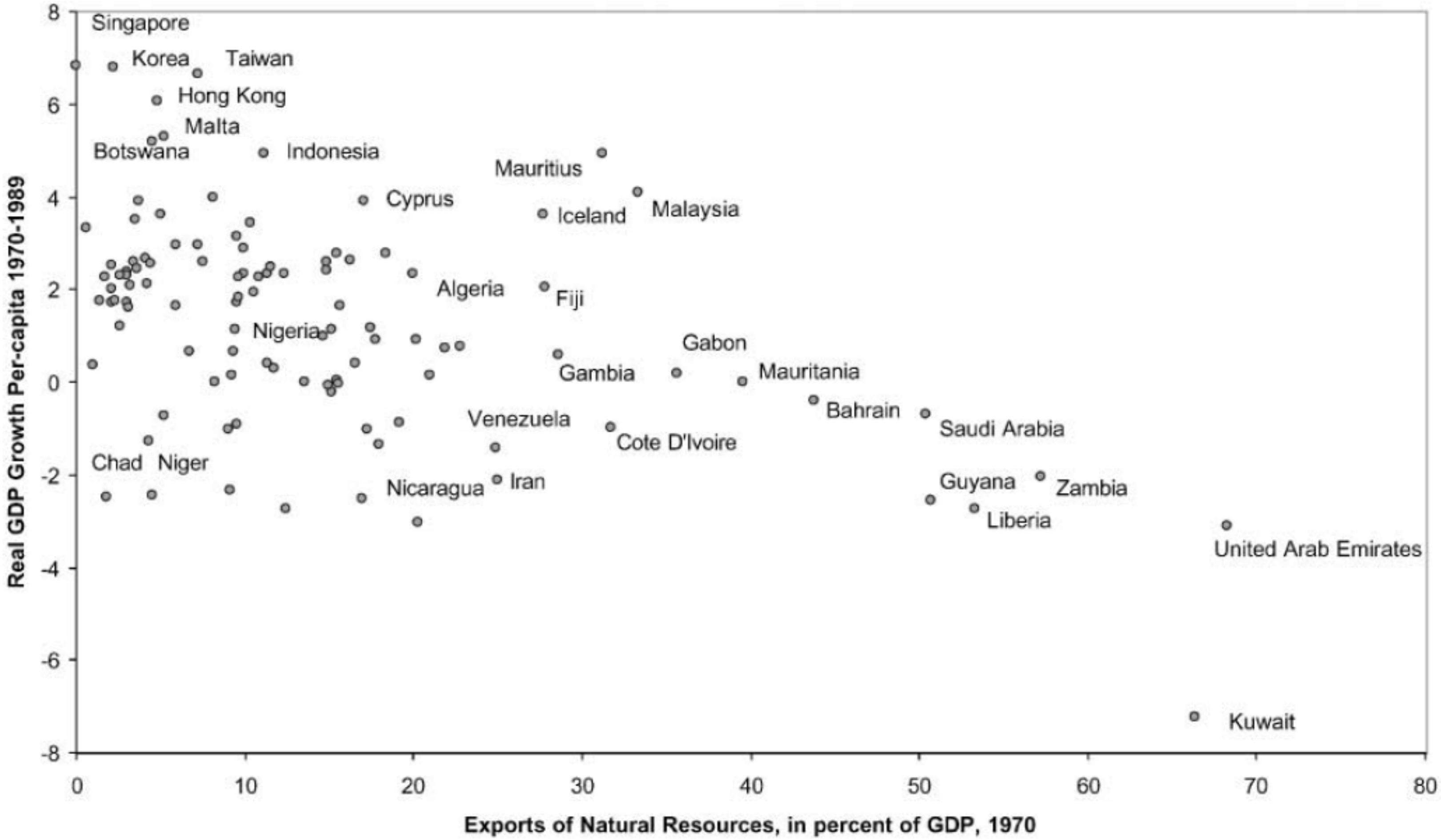
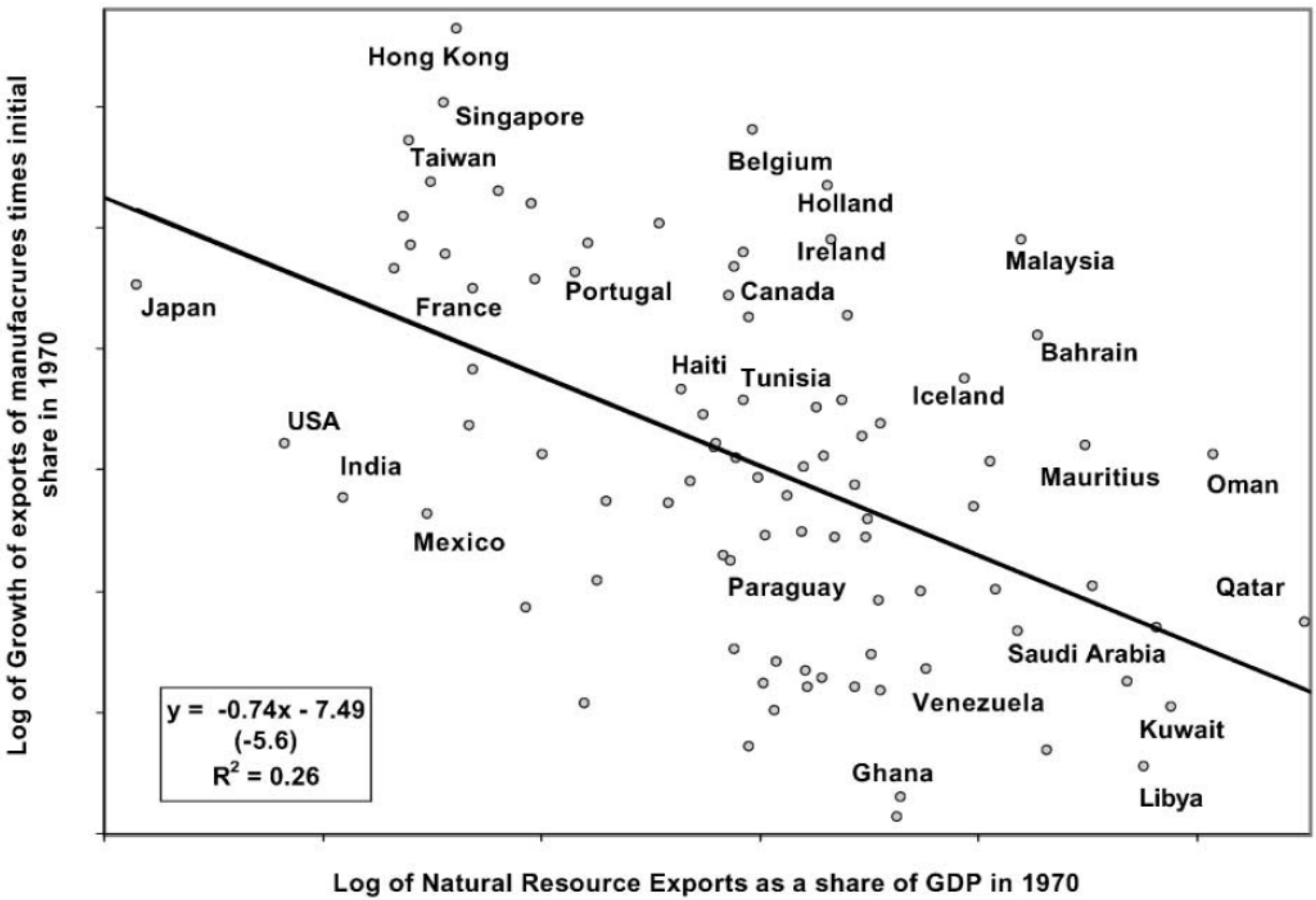


Fig. 1. Growth and natural resource abundance 1970–1989.

Sachs and Warner (2001)



Mehkum, Moene and Torvik, 2006

1. Countries with natural resources constitute both winners (Botswana, Canada, Australia, Norway) and losers (Nigeria, Zambia, Sierra Leone, Angola, Venezuela Saudi Arabia).
2. Main reason for the difference is institutions.
3. Split sample based on quality of institutions and the natural resource curse vanishes when good institutions are present.
4. This results holds in the regression analysis.

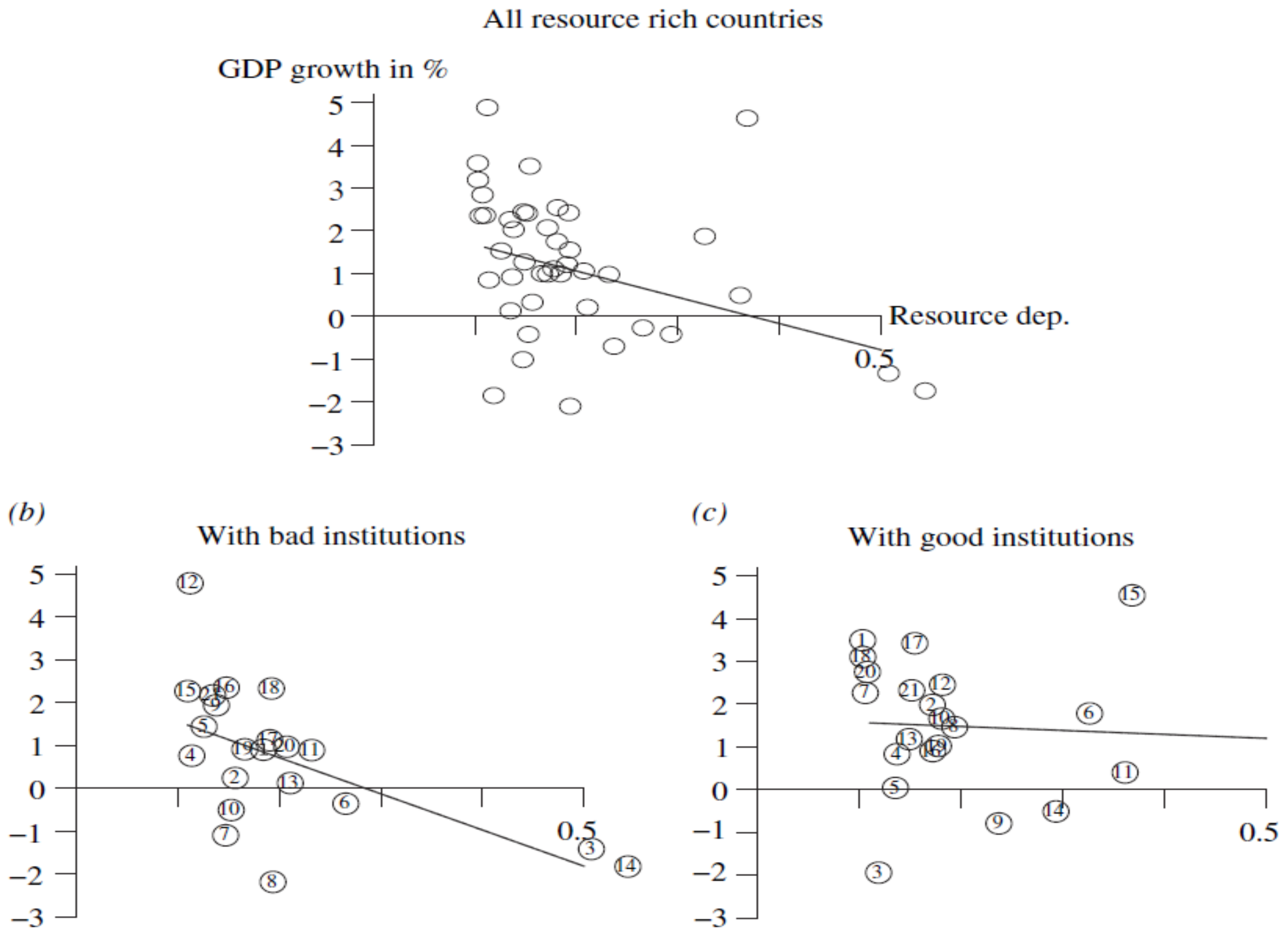


Fig. 1. *Resources and Institutions (a) all resource rich countries (b) with bad institutions (c) with good institutions*

Could there be reverse causality or omitted variables bias?

Reverse Causality

- Sachs and Warner (1997a, 2001) find no evidence of reverse causality between the measure of growth and the measure of natural resource abundance.

Omitted Variables Bias

- What about institutions being determined by GDP?
  - Acemoglu et al. (2001) using settler mortality as an instrument for institutional quality found that the effect of institutions on income becomes stronger.

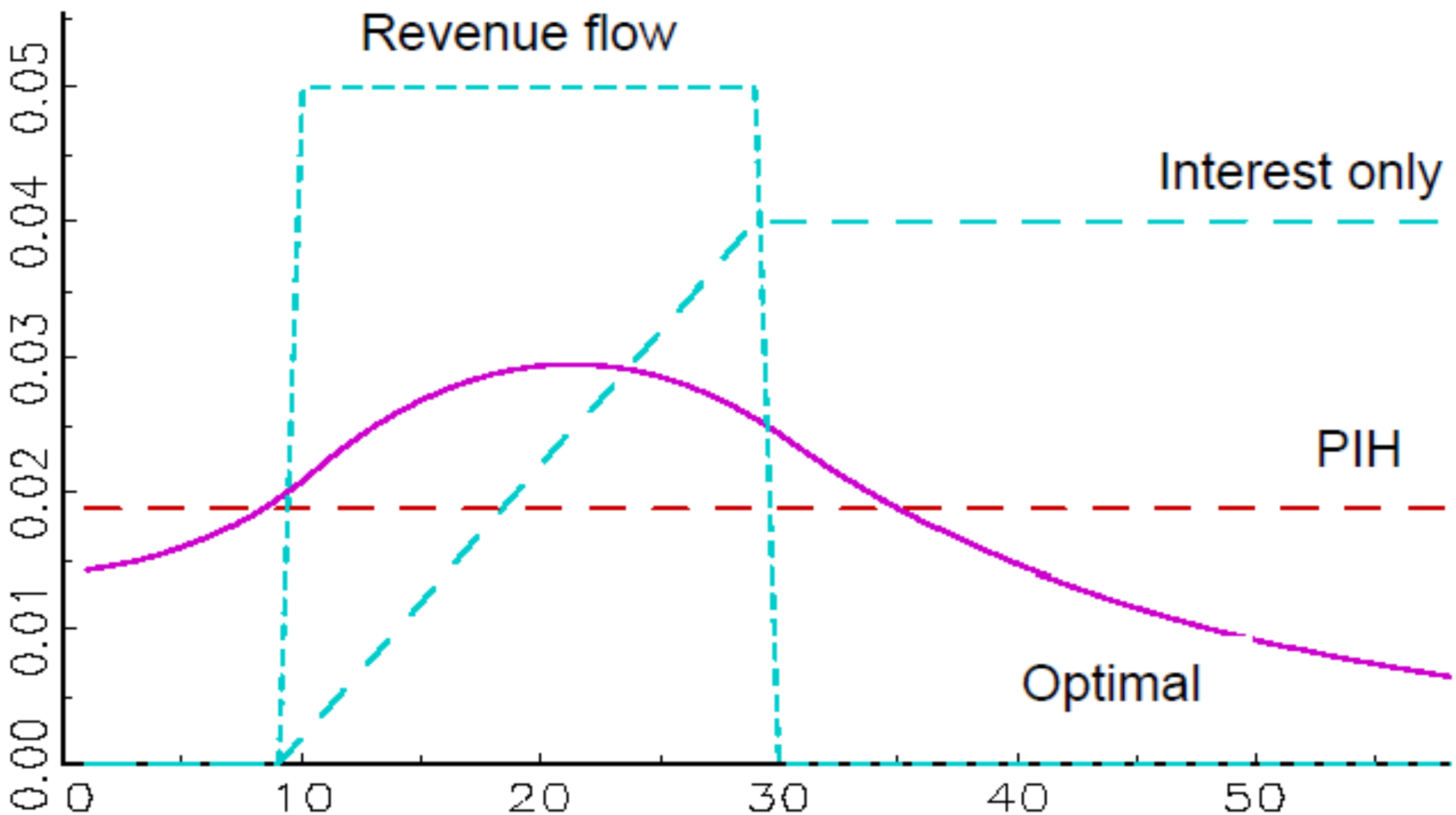
- Not likely to be the end of the story!

Natural Resource Challenges for Developing Countries

- Upstream Issues (Collier, 2008)
  - Ownership Rights (Breath of ownership, Control, Encouragement of I)
  - Taxation (Equity versus taxation)
  - Discovery Process (unknown reserves, market for information)
  - Extraction
  - Clean-up

- Downstream Issues: Focus on Use of Tax Revenues (Collier, 2008)
  1. Consumption of resource revenues should be smoothed, beginning early (perhaps before revenue flows) and certainly extending well beyond the period of peak resource revenues.
  2. The critical issue is therefore whether resource revenues can be harnessed for faster growth.
  3. Dangers of crowding out and Dutch disease effects, these can be offset by public spending designed to increase the competitiveness of private sector investments.
  4. Example: Chile's Copper Stabilization Fund (CSF)

Figure 1a: Profiles of incremental consumption



Collier & Venables (2008)

The Natural Resource Curse and Institutions

Specific Readings

1. Sachs, J. D. and Warner, A.M. (2001) *Natural Resource and Economic Development: The Curse of Natural Resources*. European Economic Review, 45, 827-838.
2. Mehlum, Moene and Torvik. (2006) *Institutions and the Resource Curse*. The Economic Journal, 116 (January), 1–20. http://www.res.org.uk/economic/freearticles/january06.pdf
3. Collier and Venables. (2008) *Managing the Exploitation of Natural Assets: lessons for low income countries.* http://users.ox.ac.uk/~econpco/research/pdfs/ManagingtheExploitationofNaturalAssets.pdf
4. Collier and Venables. (2008) Managing resource revenues: lessons for low income countries. http://users.ox.ac.uk/~econpco/research/pdfs/ManagingResourceRevenues.pdf
5. The Natural Resource Charter http://www.naturalresourcecharter.org/
6. Davis, Ossowski, Daniel and Barnett (2001) Stabilization and Savings Funds for Nonrenewable Resources Experience and Fiscal Policy Implications, IMF Occasional Paper 205.