

Is Natural Resource Wealth a 'blessing' or a 'Curse' for Economic Growth?

Aydan Mohnatova 

Introduction

Due to research and debate over this topic, studies have shown that a dependency on resources weaken economies and then in turn lead them to have a toll on human development index, nourishment of the population, life expectancy or availability of water (Bulte, Damania, and Robert T. Deacon 2005).

This question is raised particularly when the majority of East Asian countries have successfully industrialised, whilst sub-Saharan Africa and Latin America have failed to make successful use of natural resources. Auty in 1994 has emphasized that in order to discuss the extent on this issue, it is important to consider factors such as political systems or urbanization.

This paper aims to apply the resource curse thesis and manipulate findings to identify whether the latter should be regarded as a blessing or a curse. It will first go on to examine the possible side-effects regarding a resource-rich country, and then go on to examine the possible benefits encountered.

Why is the resource curse inevitable?

Taiwan and Korea during the time period of 1950, were the large newly industrializing countries that were least benefited by the autarkic industrial policy. As evidence, a study proved that the industrial structure of larger countries leads to early diversification and that they tend to be more self-sufficient or in other words, Autarkic (Perkins and Syrquin, 1989). Autarky is when a country sustains itself without international trade or external assistance. After leaving this policy and adopting the competitive industrial policy, it became easier to sustain the damage on competition that the heavy and chemical sector got from slow maturity - which damages economic growth. This may result from import and subsidy demands when the heavy and chemical sector became uncontrollable for the primary sector whose rents have decreased as the economy evolved (Auty, 1994, pg.17). Auty has also mentioned that the emphasis on rent-seeking patterns in the economy is part of the mechanism that results in failure of the Autarky policy. This means that a country might need to stress on the creation of new wealth to avoid the issues that a non-competitive environment might entail. Volatility, Crowding Out,

Autocracy, Anarchy, Civil War and Dutch Disease are the primary examples on how natural resources might affect an economy.

Volatility

Volatility in the economy of natural resource pricing is what some researchers believe will be cause economic growth to plummet (Blattman, Hwang, Hilliamson, 2007). Commodity prices can be considered as highly volatile; the market prices for natural gas and oil are mostly volatile however aluminium, bananas, coffee, copper, sugar are close. The cause for these large amounts of price volatility is primarily low short-run elasticities. This means that for any increase in prices, demand will not decrease by a large amount in the short run and neither will supply rise. These elasticities are low due to capital stock only being able to operate with a certain amount of energy or raw materials to output. Due to the time-consuming amount that adjusts output supply elasticities are also often low (2007). If there is a reduction in the supply of agricultural commodities, the price mechanism has to adjust by a large amount in order to clear the market.

Crowding out

Crowding out occurs during a constant resource boom that crowds out the manufacturing sector (Sachs and Warner, 1995). The crowding out of manufacturing is not only a result of the expansion of natural resources, but also via expansion of the government and non-tradable commodities. The inflation of these sectors is coming from extensive government spending. This effect is considered cyclical, and results in natural resources becoming bust. However, some studies also suggest, de-industrialization is a worse side-effect of the manufacturing sector because of the crowding out of non-commodity exports, which alters economic growth (Zoega, 1999). It is important to make the differentiation before the two in order to understand that not all cases of crowding-out negatively impact the economy.

Autocratic and Oligarchic Institutions

The structure and quality of institutions and government can be presumed to be the most widely debated and hypothesised in terms of the possible ways in which natural resources would be a curse to



the growth of an economy in the long-run, some might claim that corruption is the main reason and purpose.

Auty has often written of a 'rent cycling theory' where he claims that economic development requires recycling rents using markets rather than through patronage. Specifically, countries with high rent rates, natural resources out a political debate over ownership, however in countries where rent is low the government has to enthrone the public to create wealth, in order for economic growth. This can be done by promoting a civil society or by promoting inequality for example.

There is a certain hypothesis which states that there can be no taxation with the absence of representation, this theory states that democracy has a need for tax revenue. In terms of the Middle Eastern oil exports, the governments access to rents, specifically in the form of oil revenue, has lowered their dependency on tax collection, which resulted in the independency from democracy (Vandewalle, 1998). A study done by Huntington in 1991, has broadened this theory by comparing it beyond the borders of the Middle East to various states that have natural resources in the world.

This can be compared to the works of Engerman and Sokoloff, to answer on why industrialization firstly occurred in the North-Western hemisphere rather than the South-Western hemisphere. It is important to note colonization that occurred by the Europeans in Latin America, were once considered to have acquired a better find of gold and silver rather than those who have colonised North America. This occurred during the Treaty of Breda in 1667, where the Dutch and later the French were willing to give up owned lands such as New Netherland and Canada for an exchange of land in South America (Parker, 2011, pp. 138-305).

Individualism, democracy, egalitarianism and capitalism was primarily developed in areas that were suited to areas which supported farming and fishing for example in the Northeast United States. This was perhaps 'preparation' for the industrial revolution because these areas became well applicable to such reform. However, areas that were concerned with industries based on extractions were not well suited for the industrial revolution because society and the environment became well-adjusted to depend on class and authoritarianism, instead of personal incentives and dispersed decision making. Most studies that examined general cross-sections of countries after following the growth of rent-seeking and democratic propositions, have resulted with the conclusion of natural resource dependency being connected with an authoritarian government (Ross, 2001). In a study

done by Sala-I-Martin and Subramanian (2003) and Bulte, Damania, and Deacon (2005) have argued that commodities such as oil do lead to the slow progress of economic growth.

Anarchic Institutions

Anarchy as opposed to Autocracy can also lead to a varied type of institutional failure. The uncontrollable scarcity of resource, property rights and civil war have been described to be the factors that affect commodities in an Anarchy most (Solow, 1986).

What could help the scarcity of resources, or to address the issue of excessive depletion, would be to offer private businessmen full property rights would give them incentive enough to not waste these commodities. However, even so it is controversial to enforce property rights on a scarce good, since it would no longer be controlled by the state and would be used upon the will of the owner only rather than a large community of decision makers who would be more inclusive on different types of ideas and choices.

Civil war or domestic conflict has a tremendous impact on economic development. An area of land that has natural resources would have the availability of diamonds and other important resources available for anyone to obtain. This is where conflict will likely arise due to the ease in which these resources could be obtained, not requiring any sort of production or intensive labour and investment in capital to produce valuable items. In fact, there is evidence to prove that economic dependence has often resulted with civil war. Researchers have found that economic dependence on oil and mineral wealth is correlated with civil war such as in Sudan and Angola (Collier, 2007).

Dutch Disease & Procyclicality

The Dutch Disease can be defined as a real appreciation in the nominal currency (Edwards (1986). Auty has described the Dutch disease as the early 'shrinkage of agriculture and under expansion of competitive manufacturing.' This means that the growth of the non-traded goods sector or inflation is not only primarily due to real appreciation of currency. It is the implication of fiscal policy that contributes to this. Research has proven that fiscal policy does have a tendency towards being procyclical in newly developing countries if they are compared to industrialized nations (Medas and Zakhrova, 2009). What causes procyclical expenditure is often caused by political pressures that arise after there has been shocks in tax revenues, investment and government wage bills which make governments increase spending into the economy which can be unnecessary. This most likely occurs in economies where natural resources are the main

aspect of the business industry (Hamilton and Kazimov, 2011).

Reasons for being a partial blessing

There are yet benefits to be noted of the possible benefits of the resource curse. The UAE has a vast amount of the world's crude oil and gas; however, this has encouraged growth in its economy. There were many increases in life expectancy, literacy, education and health care. The government debt is fairly small and government spending has successfully established infrastructure, created employment and a well-round welfare system. To battle the issue of the scarcity of natural resources the UAE has established light manufacturing, tourism, finance and many other economical innovations that would make the economy stable on its own without the need of having natural resources. It can be revised from this that the UAE has used its natural resources as a jumping start to many more economic contributions, rather than use it as a constant commodity and waste its long-term benefits (Frederick van der Ploeg, 2011).

It can also be regarded as a blessing if transportation costs are high, the extra resources would decrease the domestic price to manufacturing giving domestic producers a comparative advantage. There might also be a higher saving rate due to the limited consumption choices by those producing with natural resources. Also, if those using natural resources made the decision to sell their rights, this might lead to shocks in consumption (2011). In the nineteenth century there was a more widespread ownership of resources, and it is important to acknowledge that it might relate to the smaller and more efficient scale of production experienced at that time (2011). The existence of natural resource act as attractive incentive to political groups to eliminate technological development which would in the long run weaken their institutional power. (Acemoglu and Robinson 2006).

Possible Solutions

If an economy experience price volatility, economic *integration* for example removing barriers that halt the flow of goods and services might ease the price fluctuations. Some studies do suggest that financial integration does smooth economic shocks (Harvard Jacks, O'Rourke and Williamson, 2011), however an article by the journal of financial economics has concluded a study with findings that integration would increase investment and lead to development in the long run. However, if the volatility originates from an unsustainable path for housing prices then integration could result in bubbles and crashes (Loutskina. E & Strahan.P.E, 2015).

The concept of privatization could ease the slow

growth of the mineral sector which public monopoly ownership of foreign capital has caused, perhaps this theory could have been applied to Sub-Saharan Africa. The key to the resource curse being well maintained, would be a well-functioning government system, that would supply goods to the natural resource sector, rather than keeping the ownership to themselves. The experiences in US do indeed confirm that the scarcity and depletion of natural reserves can be successfully tackled by technological progress in extraction and privatization of reserves (Frederick van der Ploeg, 2011). The policy lessons need not to be overlooked by most researchers, as was stated by Rosser, he claimed that it is with the understanding of various types of developmental structures, that the resource curse would be maintained, and in fact has pointed out that most resource abundant countries have performed exceptionally well over the last 10 years. Some have failed to correlate the correct policies in order to maintain the resource abundance towards further developments like Dubai has done over the years. Torvik in 2009 has stated that it is still not certain whether resource abundance is the direct cause of slow economic growth. This means that the question of causality is raised.

Results in various surveys have shown that there is a positive relationship with natural resources and real growth in Gross Domestic Product (Brunnschweiler, 2007), these were carried out over the time period of 1970 till 2000. Brunnschweiler has also stated that there is no concrete evidence over the idea that the resource curse negatively affects institutional quality which is opposed to the idea of natural resource curse behaviour such as rent seeking (2007). However, it could be noted that as institutional quality improves, the beneficial effects of economic growth proceed to diminish. Quite the contrary, he also believes that the abundance of natural resources may be considered to be more of an economic bonus to an economy (2007). East Asian countries have successfully integrated this boon to further progress their economy towards becoming more independent. It is important to manipulate an economy with policies that are suited for the individual economy, and not apply the same methods as applied to successful countries before.

Concluding Points

To conclude on whether resource abundance should be regarded as a blessing or a curse, it is important to acknowledge that with the correct economic manoeuvres such as integration and privatization, poor countries could successfully turn their resource curse into a benefit. Conflict prone countries such as Africa, would need to dwell on the firmer foundation of their weak institutions in order to control the ownership and management of natural resources (Frederick van der Ploeg, 2011).

However, most political decisions that have not worked for Sub-Saharan Africa for example, is the result of a weak and unprincipled political system and inequality in the economy.

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