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2.3 Understanding the Challenges: Changing Perspectives

Research into the benefits and costs of extractive resource development has been voluminous and has gone through a number of phases over the years, influenced often by real country experiences, such as the sudden wealth acquired by Middle East oil states in the 1970s and early 1980s¹. The principal indicators used by researchers have been growth, conflict and democracy. Initial work by development economists in the early 1960s was broadly optimistic about the benefits, arguing that natural resource abundance would enable developing countries to make the transition from underdevelopment to an industrial ‘take-off’. A decade later the trend had begun to swing sharply against this view, influenced by the ‘Dutch Disease’ phenomenon, described above. Natural resource wealth became associated with slower growth, greater inequalities and impoverishment in rural areas, as well as bad institutions and increased risk of civil conflict in the literature of the 1990s².

Some of the assumptions on which the ‘resource curse’ literature has been based have not stood up well. The influential thesis by Sachs and Warner (2001) that there is a robust inverse relationship between growth and resource riches was qualified by Hausmann and Rigobon (2003), who point out that oil-rich economies performed well economically in the 1980s when oil was doing well, contrary to what one would expect from the Dutch Disease thesis. Lederman and Maloney (2007) have argued, drawing on case studies, that resource wealth combined with appropriate policies and institutions can contribute significantly to long-term growth. Alexeev and Conrad argue that the resource curse with respect to oil is elusive and that this conclusion applies to the alleged impact on institutions. They argue that econometrics used in previous

¹ An accessible overview of the literature is provided by the authors of a study commissioned by GIZ/BMZ: ‘Curse or Blessing – Development or Misery: Scrambling to the bottom or Scrambling to the Top, Natural Resources, Economic Growth and Conflict: A literature Review’ (2011). Bonn/Eschborn: GIZ Africa Department (http://api.ning.com/files/gGXcxprhp3XY3Xw-D4u7UOdyhJxreZjbB2wwokx2SzFzvWTKCWyzMhFVfr6XrD5Ck2qYVyaN7XVOVHB8*gfAmSjyNYzFPI/SWPGIzresourcegovernancestudy2011.pdf; last visited 17 January 2014). Useful overviews of the academic literature on this subject, covering varying perspectives and published over a period of around 15 years are: Frankel, J. (2010). The Natural Resource Curse: A Survey, Faculty Research Working Paper Series No. RWP10-005. Cambridge: Harvard Kennedy School of Government. Available at: www.hks.harvard.edu (last accessed 1 April 2012); Rosser, A. (2006). The Political Economy of the Resource Curse: A Literature Survey, Institute of Development Studies Working Paper No. 268. Sussex: University of Sussex; Ross, M. (1999). The Political Economy of the Resource Curse. World Politics, Vol. 51, pp. 297-322, and F van der Ploeg, ‘Natural Resources: Curse or Blessing? 49 Journal of Economic Literature (2011), pp...

² Resource dependence has been shown to be one of the most important causes of civil wars: see the essays in I Bannon and P Collier (eds), ‘Natural Resources and Violent Conflict: Options and Actions’ (2003). The World Bank. Michael Ross (2006) has found that “the likelihood of civil wars in countries that produce oil, gas and diamonds rose sharply from the early 1970s to the late 1990s. So did the number of conflicts in which insurgents raised funds by selling contraband resources”: ‘A Closer Look at Oil, Diamonds, and Civil War’, *Annu. Rev. Polit.Sci* 9: 265-300 at 267.

studies contained flaws³. More recent work has become markedly more positive, probably because it adopts a longer historical time series on natural resources than earlier research did; it focuses on isolating the within-country relationship between natural resource revenues and economic growth or democracy, and finally it employs measures of resource abundance *per se*, instead of economic dependence upon natural resource wealth. Attention has also shifted to other important issues, not least the capacity of institutions in host countries to manage the various stages of EI activity.

Political Economy The linkage of economics to politics has provoked a growing interest in political economy among development specialists. The line of thought is that a focus on extractive resources as the source of problems is mistaken; instead, the problems are better understood as arising from institutions or from the interaction between institutions and resources⁴. In some countries a narrow concentration of political power has been identified as an important variable in conditioning the potential for negative development outcomes. Hence, a political economy form of analysis would direct attention to the particular way in which institutions distribute or concentrate power and examine the implications for possible effects of resources on economic growth, corruption, conflict and other variables. This approach is thought to capture “the interplay between politics and valuable natural assets”, which is responsible for negative effects: “politics can affect the exploitation of natural assets, and natural assets can affect politics”⁵. It has led economists to focus on the particular challenges that companies face in striking credible deals in weak institutional settings.⁶ The result of this focus has produced a number of innovative implications for contract design.⁷ Barma, Kaiser, Minh Le and Vinuela⁸ build on the results of several existing studies to identify two dimensions:

³ ‘The Elusive Curse of Oil’ (2009). *Review of Economics and Statistics*, vol. 91, no.3, pp.586-598. For another, more recent critical view, see Brock Smith, ‘The Resource Curse Exorcised: Evidence from a Panel of Countries’, OXCARE Research Paper 165.

⁴ However, case studies revealed the importance of institutions in managing resource rents many years ago. The insight is not new but a wide acceptance of its significance is. For an early example, see A Gelb, *Oil Windfalls* (1988) on Indonesia: “A more accurate statement therefore is that Indonesia’s good performance during the oil booms reflected the institutions developed earlier to nurse the economy back to health, the approach to policy set in the Suharto Government’s formative years and the *unusual degree of continuity*” (at p.223). The same author covered similar ground but at a more abstract level in RM Auty and AH Gelb (2001) *Political Economy of Resource Abundant States*, in RM Auty (2001) *Resource Abundance and Economic Development*, OUP: New York, 126-144.

⁵ Collier (2010) 1106. A systematic application of a political economy perspective is evident in the study entitled ‘*Rents to Riches? The Political Economy of Natural Resource-Led Development*’ (World Bank, 2011). It incorporates more than a dozen case studies and examines, in detail, how political economy can be applied to resource dependence.

⁶ See Hogan, W., and Sturzenegger, F. (2010). *The Natural Resources Trap*. Cambridge: MIT Press. This study considers the issue of seemingly perpetual contractual renegotiations driven by commodity price instability and how these pressures could be contained within a more stable commercial framework.

⁷ Much of the literature has focused on the information, finance, and capability asymmetries between developing state governments and transnational extractives companies. Remedies therefore focus on how to ensure that developing country governments use good practice solutions to secure a better deal. See Humphreys, M., Sachs, J., and Stiglitz, J. (eds.) (2007). *Escaping the Resource Curse*. New York: Columbia University Press.

⁸ *Rents to Riches* (2012).

political inclusiveness and inter-temporal credibility. The first of these is needed if countries are to spend rents in a broadly developmental way. The second allows countries to contract efficiently with EI companies and manage inter-temporal volatility. A typology using these two dimensions leads to principles for enhancing the development orientation of the EI sector.

Assessments of political systems and their effects have often been sceptical. Among them is the conclusion of Paul Collier that “the political systems best suited to harnessing natural assets are those least likely to develop once natural assets have become important in the economy”⁹. Even democracy proves insufficient: if there are no effective checks and balances on power, competition for natural resource rents can make democracies malfunction¹⁰. The management of resource wealth contrasts with normal taxation: it does not invite public scrutiny and accountability and encourages the emergence of patronage politics¹¹. An alternative view emphasizes the choices that governments can make, taking the context into account: “a natural resource boom can have effects that go in different directions, and which effects dominate may depend on existing institutions, structural and economic factors, and other variables”¹². Some research has attempted to rank countries according to particular forms of political system, rather in the way that some think-tanks have done so with respect to political risk, albeit with the difference that the audience for the former kind of research is not primarily one of corporate investors¹³.

For those institutions engaged in the provision of development assistance, the political economic approach has proved attractive. A World Bank senior official has stated: “(a) consensus is emerging that policies will be effective in leveraging natural resource-led development only when they are compatible with the level of institutional quality and the political economy context of the country in question”. They have generally endorsed the conclusion of political economy scholars that “it is futile to try to change economic institutions without considering the underlying political forces through which they emerged and are sustained”¹⁴. Yet those are the very institutions that need to be targeted if the negative effects of resource development are to be avoided. As several of the IMF’s leading advisers have noted, “(t)he effectiveness of public investments depends upon institutional factors, such as

⁹ Collier (2010) 1106.

¹⁰ Collier (2010) notes that in failing states incumbents can win elections by means of technologies that are excluded in a conventional election because they are illegitimate: for example, vote-buying; voter intimidation and ballot fraud: p.1113.

¹¹ P Collier (2008), *The Bottom Billion*, OUP: Oxford.

¹² Thad Dunning, *The Political Economy of the Resource Paradox: An Overview* (2008), World Bank: Washington D.C.

¹³ *Rents to Riches? The Political Economy of Natural Resource-Led Development*. Washington, D.C.: World Bank Publications, p.69 at Figures 2.6 and 2.7; compare the Fraser Institute’s *Surveys of Mining and Petroleum*: <http://www.fraserinstitute.org/>

¹⁴ NH Barma, K Kaiser, TM Le and L Vinuela, *Rents to Riches*, at p.39, noting in particular the work of D Acemoglu and JA Robinson (2010), *The Role of Institutions in Growth and Development*, in *Leadership and Growth* (eds. D Brady and M Spence), pp.135-64. Washington D.C: Commission on Growth and Development and World Bank.

the capacity to select, implement, and evaluate projects”¹⁵. Without a thorough, critical analysis of the political economy of those institutions, specific interventions by development institutions may well fail. An example of political economy analysis in use by a development institution is provided by the OECD in relation to fragile states. Its general view was that state-building should be the central objective of assistance and that the best way to achieve this is by focusing on state legitimacy and state-society relations. In a study of Kenya¹⁶, using political economy analysis of this type, three dimensions of state legitimacy were identified: how the state functions; what the state does and what beliefs the citizens have of what is legitimate. The results were offered to NORAD as a series of recommendations for its current and proposed interventions.

Another strand in research on the ‘resource curse’ has addressed measures of resource dependence and resource abundance. States in the former group have been viewed as more vulnerable to the negative effects of natural resource development. Yet recent research suggests that once resource abundance (proxied as a measure of natural resource wealth) rather than resource dependence (the average national income share of natural resource exports over a defined period) is used, “the effect of natural resources on growth performance is positive and thus the resource curse disappears”¹⁷. This kind of research is significant in the light of recent trends in global demand for natural resources, which have encouraged new discoveries of hydrocarbons and minerals as well as intensified extraction of existing deposits in the ‘frontier areas’ of the developing world. The east coast of Africa is a vivid illustration of this push for fresh discoveries and its remarkable potential for wider impacts on the region. The share of global rents derived from petroleum in sub-Saharan Africa increased six times during the period 2000 to 2008, with oil rents representing more than two thirds of the total¹⁸. East Asia Pacific’s share grew from nine to 17 per cent of the total during the same period. *This underlines the growing number of states that are becoming resource-dependent*, and the need for access to guidance on policy design to counter those political economy factors that can lead to negative outcomes. As this review shows, the risk of such outcomes is more likely to be present among poor countries, less diversified than others and with fewer institutional resources to cope with the impacts of resource development.

The end of a long boom period in mining and hydrocarbons from about 2014 has triggered further reflections on the resource curse theme. Just as a consensus appeared to have emerged that this seductive but counter-intuitive idea had too many flaws to be useful, it appeared that

¹⁵ P Daniel, S Gupta, T Mattina and A Segura-Ubierno, *Extracting Resource Revenues*, Finance & Development (2013), p.21.

¹⁶ G Sundet and E Moen, *Political Economy Analysis of Kenya*, Report 19/2009 (2009), Oslo: NORAD.

¹⁷ F van der Ploeg and S Poelhekke, *Volatility and the Natural Resource Curse*, OXCARE Paper, 737

¹⁸ World Bank (2011). *Rents to Riches? The Political Economy of Natural Resource-Led Development*. Washington, D.C.: World Bank Publications, p. 11.

many resource-rich countries had reached the end of this boom with little to show for it and with the prospect of hard times ahead. Why is development for them proving to be so hard, came the question¹⁹. Has the resource curse idea touched on some connection between extractives and development that merits further research?²⁰ It is too early to say what the new round of inquiry into this theme will yield.

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¹⁹ AJ Venables, 'Using Natural Resources for Development: Why has it proven so Difficult?', <http://www.oxcarre.ox.ac.uk/images/stories/papers/ResearchPapers/oxcarrerp2016169.pdf> (last visited 6 April 2016)

²⁰ For example, P Stevens, G Lahn and J Kooroshy (2015), The Resource Curse Revisited, Research Paper, Chatham House: "while it is not inevitable, the resource curse is alive and active" (p.3)