NRGI Reader
March 2015

Natural Resource Governance Institute

The Resource Curse

The Political and Economic Challenges of Natural Resource Wealth

KEY MESSAGES

- The term resource curse encompasses the significant social, economic and political challenges that are unique to countries rich in oil, gas and minerals.
- Many oil-, gas- and mineral-rich countries have failed to reach their full potential as a result of their natural resource wealth. In general, they are also more authoritarian, more prone to conflict, and less economically stable than countries without these resources.
- While there are many challenges unique to oil, mining and gas extraction, governments can make policy decisions that help avoid some of the negative consequences of extraction and maximize the benefits.

"Countries with non-renewable resource wealth face both an opportunity and a challenge. When used well, these resources can create greater prosperity for current and future generations; used poorly, or squandered, they can cause economic instability, social conflict, and lasting environmental damage."

— Natural Resource Charter, Introduction

WHAT IS THE RESOURCE CURSE?

The *resource curse* (also known as the *paradox of plenty*) refers to the failure of many resource-rich countries to benefit fully from their natural resource wealth, and for governments in these countries to respond effectively to public welfare needs. While one might expect to see better development outcomes after countries discover natural resources, resource-rich countries tend to have higher rates of conflict and authoritarianism, and lower rates of economic stability and economic growth, compared to their non-resource-rich neighbors. This reader describes political and economy theories about why some resource rich countries do not do as well as expected.

CAUSES AND EFFECTS OF THE RESOURCE CURSE

Political scientists and economists argue that oil, mineral and gas wealth is distinct from other types of wealth because of its large upfront costs, long production timeline, site-specific nature, scale (sometimes referred to as large *rents*), price and production volatility, non-renewable nature, and the secrecy of the industry. Below are some of the leading observations and theories about how these special characteristics of natural resource revenues create additional challenges for countries:

This reader is intended for use in conjunction with the Natural Resource Charter.

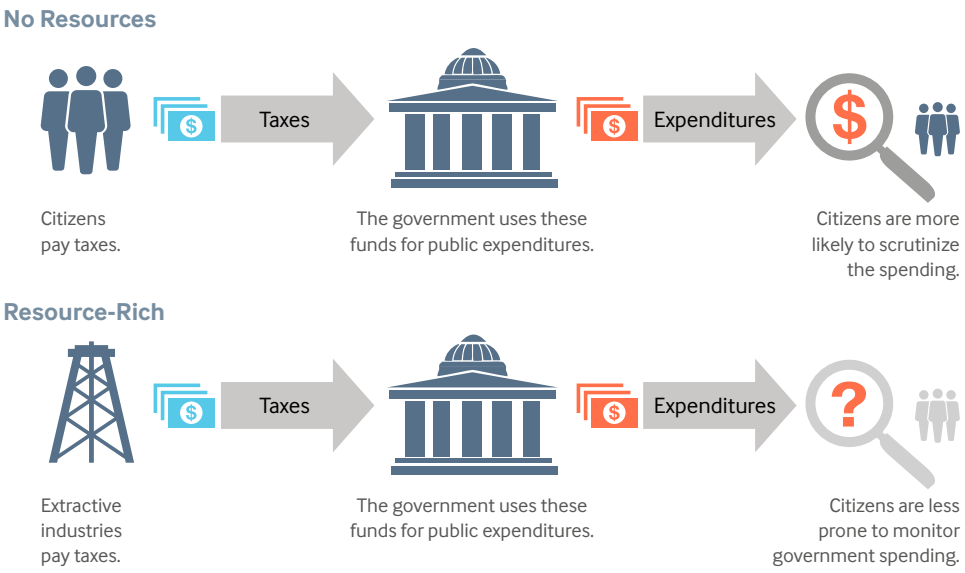

Figure 1. Oversight incentives in resource-rich and resource-poor countries.

Source: NRGI

- **Democracy**: Natural resource wealth, particularly oil wealth, has made it more likely for governments to become or remain authoritarian over the past 30 years. The explanation for this lies in taxation. In general, political scientists find that governments are more responsive to their citizens and are more likely to transition to democracy when government spending is reliant on citizen taxation. When countries collect large revenues from natural resources, they are less dependent on levying taxes on citizens, and thus citizens feel less invested in the national budget. Politicians and government officials are also less directly tied to citizen requests or demands. Further, when resource revenues are secret, citizens do not have a clear sense of whether the resource revenues are being spent well or not. Those who outline this theory suggest that the tendency toward authoritarianism can be mitigated by increasing transparency of revenues and strengthening the links between government and citizens through citizen participation in budgeting or direct distribution of wealth (e.g., cash transfers).
- **Conflict**: Natural resources can, and often do, provoke and sustain internal conflicts as different groups fight for control of the resources or use natural resources to finance their fighting. Since 1990, oil-producing countries have been twice as likely to have a civil war compared with non-oil-producing countries. Political scientists point to examples of the Democratic Republic of the Congo, the Niger Delta, Iraq, Libya and Angola to illustrate this tendency. *Petro-aggression*, the tendency of oil-rich states to instigate or be targets of international conflict, has been observed in some cases, such as with Iraq's invasion of Iran and Kuwait, but researchers debate whether the data supports the conclusion that resource-rich countries do this at a greater rate than non-resource-rich countries.
- **Inefficient spending and borrowing:** The amount that governments collect in resource revenues can change drastically from year to year because of changes in commodities prices and production. Several studies have shown that it is very difficult to effectively spend fluctuating and unpredictable revenues. Governments often get trapped in boom-bust cycles where they spend on legacy projects, such as airports and monuments, when revenues are rising and then must make painful cuts when revenues decline. Resource-rich governments have a tendency to

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over-spend on government salaries, inefficient fuel subsidies and large monuments and to underspend on health, education and other social services. In addition, governments often over-borrow because they have improved credit-worthiness when revenues are high. This type of behavior led to debt crises when revenues declined in Mexico, Nigeria and Venezuela in the 1980s. The private sector can be similarly impacted, as it can over-invest in boom times and then experience widespread bankruptcy during busts.

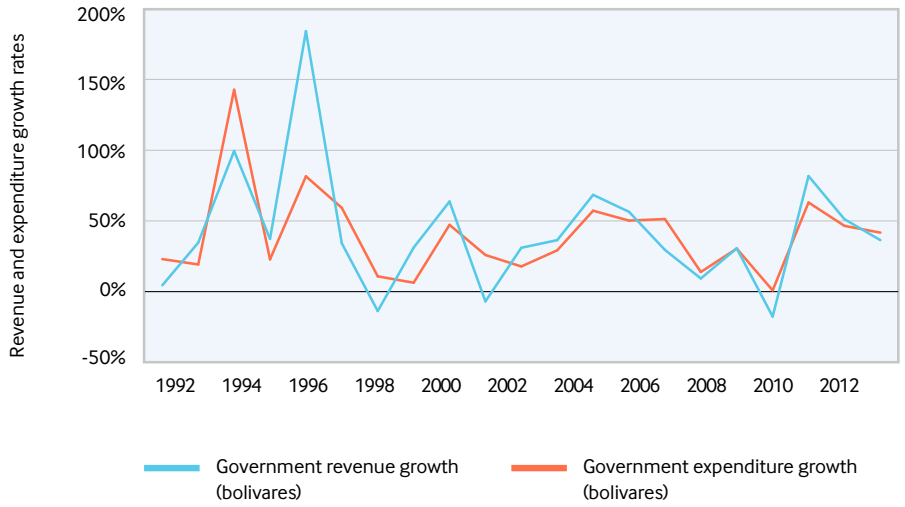

Figure 2. Expenditure volatility in Venezuela follows revenue volatility

- **Dutch disease:** A large increase in natural resource revenues can hurt other sectors of the economy, particularly export-based manufacturing, by causing inflation or exchange rate appreciation and shifting labor and capital from the non-resource sector to the resource sector (see revenue management reader). This is known as "Dutch disease." While inflation and exchange rate appreciation can harm large swathes of the economy over within a few years, their impacts can be felt for decades. The detrimental effect of natural resources on other industries has been well documented in Iran, Russia, Trinidad and Tobago, and Venezuela, all of which have either stunted manufacturing sectors or saw a precipitous decline in manufacturing. These impacts can be minimized if the country has the *absorptive capacity* to transform resource revenue inflows into tangible investments, such as roads and electricity; the government uses resource revenues to make investments in the economy that generate non-resource sector growth; or the government places a portion of its resource revenues in foreign assets. Over the last 25 years, Chile, Indonesia, Norway and the UAE have largely managed to overcome Dutch disease.

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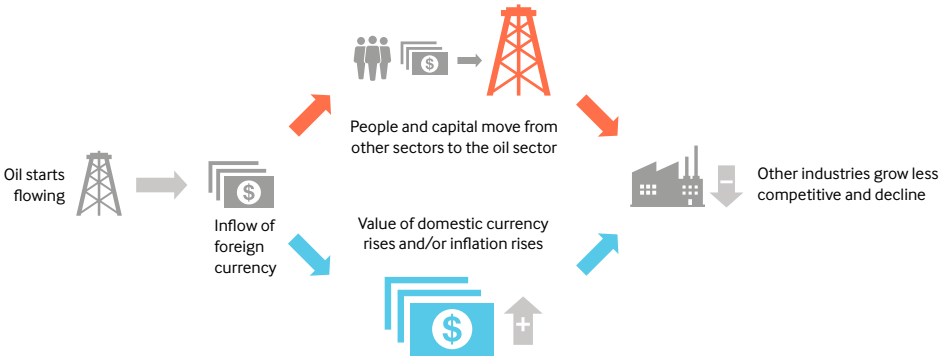

Figure 3. Dutch disease

- **Patriarchy and gender-based challenges:** Natural resource wealth seems to disproportionately impact women. Recent research indicates that oil-rich countries tend to have fewer women in the workforce and a smaller representation of women in government. One explanation for this is that industries that are usually easier for women to enter, such as export-oriented manufacturing, are less likely to succeed in resource-rich countries because of Dutch disease. In addition, studies have shown that women in resource-rich regions often have higher rates of HIV/AIDS and other life-threatening diseases. The large influx of men to communities surrounding a mine has also been associated with an increase in rates of gender-based violence. This trend is particularly concerning as study after study shows that gender reforms are key to lasting poverty reduction. To address this, researchers suggest countries take steps to protect manufacturing through avoiding Dutch disease and that governments surrounding resource-rich areas include gender perspectives in their development plans.

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- **Limited government capture of benefits:** In some cases, only a small share of the production value of the resource stays in the country. One explanation is that many *fiscal regimes*, rules about how to split the profits between companies and governments, fail to compensate the state and communities for depleting their resources and related environmental damage or loss of livelihood. These bad deals can happen when countries are so eager to encourage resource extraction that they lower the rates for taxes and royalties without understanding the true value of their resources. In Argentina, Canada, the United States and South Africa, the average effective tax rate (AETR) on many oil projects is less than 50 percent, and in Cameroon, DRC, Peru and the Philippines, the AETR on many mining project is less than 40 percent. In comparison, the AETR on many oil projects in Angola, Libya, Norway and Timor-Leste is more than 70 percent. Also, in capital-intensive (rather than labor-intensive) extractive industries, few non-tax benefits, such as jobs, accrue to locals. While expectations for *local content*, that is employment, local business development and improved workforce skills, are often very high, the actual number of opportunities may be few. The industry has a very low employment rate relative to the size of investments and those jobs, and the machinery required to implement them, mostly imported from abroad, tends to be extremely specialized.

- **Weaker institutional development:** Some researchers argue that institutions are weaker in resource-rich countries because it is easy for elites to capture or take large sums of cash. The theory suggests that large single-point sources of revenue, such as an oil project, can be managed outside the normal budget process and are relatively easily captured by powerful elites. Examples of tools used to capture revenues include sovereign wealth funds, national oil companies and contractors for extractive operations. As such, elites in natural resource-rich countries are less likely to invest in productive enterprises, such as job-creating manufacturing industries, and instead pursue *rent-seeking*, that is, fight for control of these resources. In some cases, politicians or government officials have also purposefully dismantled societal checks or created new regulations to get access to these resources or to provide access to friends or family, a process nicknamed *rent-seizing*. Some argue that elite focus on rent-seeking and rent-seizing promotes corruption and is damaging to institutional development. In turn, the theory suggests that countries with elite rent-seekers and rent-seizers tend to have weaker institutions

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and lower levels of public service delivery. The data behind this theory is hotly debated, but there are well-documented examples in Afghanistan, Sierra Leone and Tunisia.

- **Social and environmental problems**: The point-source nature of extractive industries often creates challenges when trying to balance the needs of the people and environments that surround the mining area. Sharing and compensating for resources such as land, water and the minerals can create conflict between the extraction companies and the communities. In addition, extraction projects often attract large influxes of people, whether or not additional employment is actually available. This can cause stress on economic, social and cultural relations. Environmental issues include a host of problems, such as dust from mining, scarring of the landscape, noise from process operation, contamination of hydric sources (from waste rock and tailing disposal), massive use of water in the extractive process, gas flaring (causing health problems and wasteful CO2 emissions) and seismic disturbances. In addition, many of the political and economic problems outlined above constitute or can result in the violation of human rights. The contract between the government and the extraction company could address these issues and clarify whose responsibility it is to manage these impacts.

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The resource curse is not inevitable, and several countries that have natural resource wealth do not exhibit many of these tendencies. Because of the theoretical connotation of the term, NRGI refers to the many challenges described above as "challenges associated with natural resource extraction" rather than the resource curse. That said, some studies have shown that low-income countries are more vulnerable to resource curse challenges. As there are an increasing number of new discoveries in low-income countries, it is useful for policymakers to be aware of these trends so that they can respond appropriately. The Natural Resource Charter is one tool developed in response to this research to help countries understand the risks and opportunities at various decision points in natural resource governance.

QUESTIONS TO ASK:

- How are natural resource revenues impacting other industries in my country?
- What is the individual tax rate in my country? If individual taxes are low, how are citizens holding the government accountable for resource spending?
- What is the relationship, if any, between resources and conflict in my country? Resources and military spending?
- What is my country doing to respond to the changing prices of minerals and the limited time of production?
- What steps is my government taking to mitigate the environmental impacts of the extractive industry? What steps are companies taking?

ADDITIONAL RESOURCES

Natural Resource Charter (2nd edition, 2014), available at: http://www.resourcegovernance.org/sites/default/files/NRCJ1193_natural_resource_charter_19.6.14.pdf.

Bauer, Andrew, and Juan Carlos Quiroz , *Resource Governance in the Handbook of Global Energy Policy* (ed. Andreas Goldthau, Wiley-Blackwell, 2013).

Humphreys, M., et al, *Introduction in "Escaping the Resource Curse"* (Columbia University Press, 2007).

Ross, Michael, The Oil Curse (Princeton UP, 2012).

Van der Ploeg, Rick, *Natural Resources: Curse or Blessing?*, CESifo Working Paper 3125, available at: https://ideas.repec.org/p/ces/ceswps/_3125.html.