The Resource Curse Thesis: Main arguments & authors

A Literature overview by Caetano Penna

Origins

- Until the 1980s (despite the articles by Singer and by Prebisch in 1950), "conventional wisdom" was that natural resources was advantageous for development.
- On the edition of November 26th, 1977 of *The Economist* an article with the title "The Dutch Disease" was published.
- In the 1980s, the "wisdom" started to be contested, and many works relating underdevelopment to natural resource abundance were published.
- The Resource Curse thesis received more attention again in the 1990s, with the study on cross-country evidence on the matter by Sachs & Warner (1995)

Evidences: poor economic performance

- The negative correlation between economic performance and natural resource abundance (or booming income from natural resources exports) was found by many authors (e.g. Nankani 1979, Corden & Neary 1982, Wheeler 1984, Gelb and Associates 1988, Auty 1993, Sachs & Warner 1995).
- In the work of Sachs & Warner (1995), "there is no role for quality of institutions or bureaucratic quality in explaining the natural resource curse", but evidence from other authors show that "the key point is that resource abundance makes countries with bad institutions even more vulnerable" (van der Ploeg 2006, p. 7-8).

Evidences: prone to conflict

- Another line of research, beginning with the seminal article by Collier & Hoeffler (1998), found evidence of a positive relationship between abundance in natural resources and the likelihood of civil wars.

Evidence: bad governance

- The third sub-literature on the resource curse thesis found evidence that natural resources rich countries tend to authoritarian regimes (or low levels of democracy) and to poor governance – one of the main authors in this line is Wantchekon (1999).
- Important to note that this sub-group converges to the economic performance one, as for some authors (e.g. Auty 1997) natural resources has adverse effects on institutional quality, thus affecting economic growth.

Main arguments & authors I

"**Countries whose economy is dependent in the export of natural resources tend to have poor economic performance because of the deterioration of its terms of trade.**"

Singer (1950), Prebisch (1950)

Comment: In later articles, Singer (1971) revisited his theory and argued that not all manufacturing countries would experience rising terms of trade, emphasizing the importance of barriers to entry, increasing returns and innovation (Kaplinsky ????).

Main arguments & authors II

"**Agriculture have decreasing marginal products, which is translated in higher land rents.**"

Malthus (1798), Ricardo (1817)

Comment: Modern technologies – machinery, biotechnology, fertilizers – have increased the productivity of land, however, this has not yet been translated into wage increases or higher profits.

Main arguments & authors III

"**The rent created in consequence of increasing productivity in agriculture is transferred to consumers in the form of lower prices.**"

Singer (1950), Prebisch(1950)

Comment: Technologies that improve productivity in the primary sector are produced *outside* the sector (the benefits of innovation is kept in the other sector). Moreover, by definition, producers of commodities do not control prices; these are given by the market, where information is almost "perfect": a fantastic crop will be translated into lower prices and not higher margins to producers.

Main arguments & authors IV

“**In primary activities, wages tends to subsistence levels.**”

Malthus (1798), Singer (1950)

Comment: This would be explained by the fact that labour is abundant in low income economies.

Main arguments & authors V

“**International commodity markets are volatile, what can easily be transferred to domestic economies, affecting government revenues and foreign exchange supplies, thus increasing risks for private investors.**”

Singer (1950, 1971), Nurske (1958) and Levin (1960)

Comment: Volatility also related to seasonality and gestation periods. Moreover, speculation of agents in future markets amplifies such inherent volatility of commodities markets.

Main arguments & authors VI

“**Resource rich countries depend on foreign investment to develop reserves. And multinationals tend to repatriate profits instead of reinvest them in the economy**”

Furtado (2000), Hirschman (1958)

Comment: Reliance on external funding may translate itself in financial fragility. Moreover, this often implies lack of frontward and backward linkages. And multinationals may have vested interest in conflicts.

Main arguments & authors VII

The Dutch Disease

“**International currency revenues from a booming sector exporting natural resources appreciate the real exchange rate, damaging manufacturing and other tradable sectors.**”

Corden & Neary (1982), Corden (1984)

Comment: Damaged manufacturing sectors may not be able to recover when the boom ends. Payment of subsidies to these sectors during the boom is a possible solution.

Main arguments & authors VIII

“**Resource wealth leads to unsustainable government policies.**”

Ross (1999)

Comment: This can be translated into borrowing excessively or dressing-up the welfare state. The reason would be shortsightedness of policy makers.

Main arguments & authors IX

“**Resource wealth induces corruption, rent seeking and conflict.**”

Ross (1999), Garaibeh (1987), Chaudhry (1994)

Comment: Rent seeking and productive activities are seen as competing, and thus the former can cause de-industrialization. Corruption and conflict are negatively correlated to economic performance.

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