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Natural Resources: Poverty, Government and Elites

Abstract

These essay tries to answer the question on if it is real a Natural Resources Curse and if it does, why it happens. The study goes on a small review of literature about the topics explaining what has been found before and the most known theories. After the review in which arguments in favor and against the main theory are presented, the essay presents findings and analysis with special focus on the conditions that cause the natural resources to influence the policy making on a negative way dulled by the rent seekers and the economic elites, as well as the other groups creating conflict in order to take advantage from the benefits of others.

Introduction

On the question of why countries rich in natural resources are poor and the countries lacking them are rich, this essay's intention is to answer part of it by demonstrating that the abundance of natural resources creates bad institutions, bad policies and tends to conflict. The essay accepts that countries with abundance of these resources such as tropical countries and middle east countries have not been able to solve the poverty issues they suffer and that it is not a randomized effect. Poor countries with abundance of natural resources are poor because the administration of these resources is not efficient on the systems of free market, globalized economy and the pursuit of democracy.

In this essay, evidence is compiled from previous studies and finds the refutations to those to strengthen the previous hypothesis. On an overview the literature review goes around the topic known as the Natural Resources Curse. These investigations became trending material after the great oil crisis in the decade of the 1970. Most of the relevant studies on this area undertook the question about why the countries producing a relevant and demanded product as oil were not capable, through years, to avoid the harmful effects of international crisis and to overcome poverty and underdevelopment.

The rising concerns about oil then went extended to other countries with abundant resources such as energy, water, minerals, fertile land, climate favor and more. Countries in the tropic are usually finding trouble in developing and economic growth. The literature suggests that countries with abundant resources are poor not only because of the mere existence or presence of these, but because of bad institutions. After the consensus on bad institutions catalyzing these effects for underdeveloped countries the next question risen is if these bad institutions are related to the presence of resources or are a mere randomized situation.

The analysis presented tries to explain the relation between natural resources and underdevelopment as a consequence of the bad policies with origin in the conflicts around them and the rent seeking activities dominated by the elites. Regarding elites, the cause of underdevelopment is not because of the presence of them but because of the context in which they act to protect interests in favor of market or against it.

Literature review

While many scientists have tried to demonstrate that certain conditions on the tropical or rich countries in natural resources makes them fail on the economic policies and development, some of the studies found evidence supporting the hypothesis that it is not geography *per se*, nor the climate conditions which erode the economic development, but the incentives and social conditions that these places and the abundance of resources are the cause of bad governments and bad policies.

It is important to have on mind that most of the cases studied on this topic are related to the international oil crisis and the concerns risen on why these countries with abundance of oil were not capable of tackling poverty. However, the cases related to countries exporters of commodities has ancient examples such as the better performance of non-colonialist or extractive countries, like the Netherlands compared to the rich extractive countries like Spain in the economic performance of XVII century (Rodríguez & Gómez, 2014).

After some cases observed as the ones mentioned before, studies have diverged in many different theories about the relation between the abundance and poverty in these countries. Paul Collier explained that the poorest countries in the world are in those conditions due to the combination of four circumstances called traps, where one of them is the natural resource trap (Collier, 2007). This trap exists due to the volatility of the revenues in natural resources and the negative effects on some consequences of the behavior on exportations. In one hand, countries who strongly depend on natural resources are not able to perform very good because they suffer harder the loss of income or revenue of those resources and lack of other sources of wealth. In the other hand, the good performance of one of the goods can affect directly and frequently to the economic sectors on other goods due to the appreciation of the currency on big exportations, known as the Dutch disease.

On natural resources, literature also describes and classifies these in two ways for countries. Natural resources in a country might be “pointy” which means clustered and only in specific spaces like minerals and oil, while diffuse resources are in many different spaces and with an easier division of control, like agriculture and fertile lands, etc. (Bulte & Wick, 2006). Even though only the pointy resources are the most propense to conflict due to the locked spaces and the high costs to extract them, the diffuse resources can be a source of wealth but also a source of poverty, as they receive benefits and behave similar in rent seeking activities, that might make their countries’ economies depend on them.

Another two traps identified by Collier are the Conflict and the Bad Government traps. The conflict trap is that one related to the countries unable of reaching peace and the lifestyle of activity in non-violent contexts (Collier, 2007). This trap is strongly related to the natural resource trap, even though without implying that all countries with natural resources are violent, there is evidence shown that profitable natural resources can lead to conflict situations and that these situations are potentialized by bad policies. The policies towards natural resources have been reviewed over time, shifting from privatizations, nationalizations, concessions and more. Joseph Stiglitz recommended four policies on natural resources for breaking the curse which are: determining rates of extraction as long as they are profitable, considering a "green GDP" to take in count the run-out of these resources, create stabilizing funds, reduce corruption and bribes and design contracts for government and multinational extraction companies (Stiglitz, 2005). The recommendations of Stiglitz are clearly focused on the relation between the control of resources of Government and corruption or distortions on these policies. Controlling natural resources on both nationalization and privatization methods, tends to create bad mechanisms for the distribution of that wealth since the maximum profit incentives the rent seeking actions trying to diminish the costs on the public or collective and receiving all the benefits on a limited elite. As explained by Rodríguez and Gómez, analyzing Trovik (2006) the abundance of natural resources increases the number of rent seekers and reduces the number of people related to real productive activity. These phenomena is also addressed by Sala i Martin and Ardvin Subramanian (2003) as they use the classified term the "voracity effect" from Tornell and Lane (1999), causing distortions on the economic policy and harming citizens and economic sectors not related of benefited from those rents.

After many different reviews, there is a vast amount of studies showing how the abundance of natural resources is harmful for the political system or the policy making process causing corruption and the weakening of institutions in control of order, peace and prosperity. The problem of political institutions in countries with natural resources is that these natural resources, as sources of income, shape the way State is designed, changing to controlling resources rather than facilitating the revenue of them (Kaldor, 2007). What Kaldor explains is that on the model of financing states, the countries with abundant natural resources tend to be more rentist states financing government with the income of those sources whether by specific and easy taxation or by the nationalization of those rather than a democratic tax-spend model in which people are close demanding accountability.

On the vast literature of the Natural Resources Curse, as it is known, one of the most important refutations is from Ding and Field (2005), explaining the relation between natural resources abundance and low economic growth as a problem on endogeneity. The central argument of that paper is that the frequently studied countries on natural resource curse have other problems than explain better the underdevelopment than resources by themselves. The equation demonstrates that these countries lack investment in human capital understood as spending in education as percentage of GDP. The low investment for human capital as well as the bad institutions such as rule of law and market openness are good to explain the bad performance, but it is not demonstrated that these are not related to the same problem of the abundance of resources, particularly the last two of those.

The literature around the problem of natural resources and if it is a curse or not is wide and hasn’t reached a conclusion point. This essay is not completely an essay of economic growth because won’t explain that theory such as Solow model or other, but it’s a paper of development that has been described by Amartya Sen and classified by the UN and other institutions like the Social Progress Index. Even though Sen (1999) described development as a wide set of conditions that permit liberty and the realization of what individuals pursue, in these papers the poor countries are also underdeveloped countries while not all the rich countries can be classified as developed.

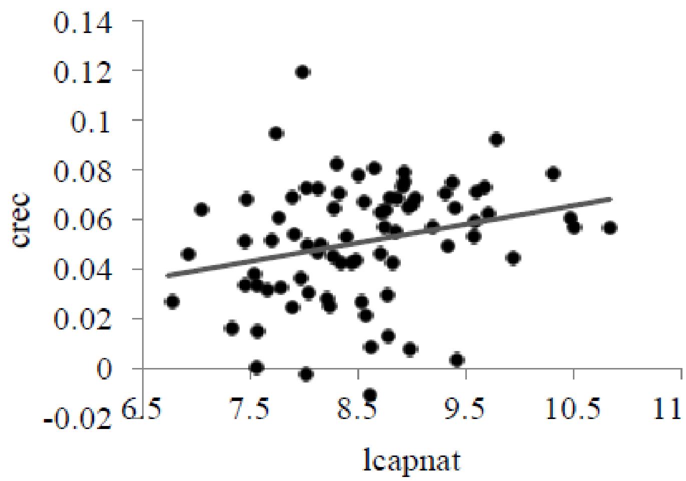
Methodology and research methods

As stated before, this study uses data and research from other studies done before about this area. That means the intention of the essay is to review previously given evidence and comment and take on some new thought from it, and not providing new information nor data.

The evidence presented in previous studies suggest both, arguments with or against the idea of the natural resource curse. Most of them, relating the GDP o GNI with the abundance and quantities of natural resources in determined countries, as well as the indicators on development like the Human Development Index.

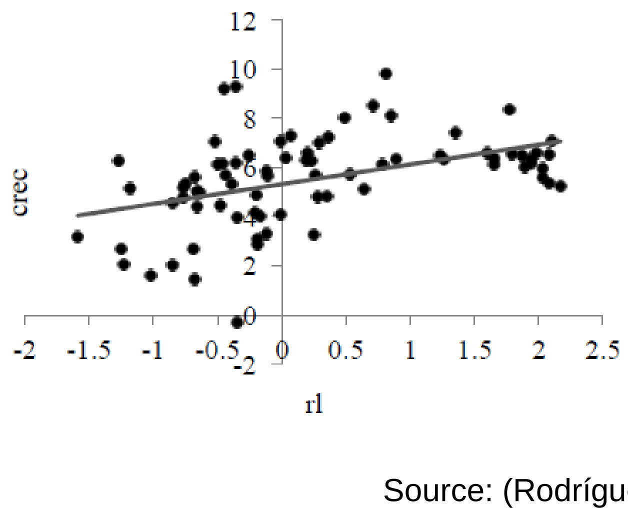
The most related study presenting evidence for this essay is from Rodríguez and Gómez (2014) presenting the correlation between the abundance of resources and the economic performance of countries as well as the development of these. The relevant variables chosen by the authors are: growth, natural capital, institutions, and HDI.

Economic Growth and Natural Capital



Source: (Rodríguez & Gómez, 2014)

Economic Growth and Institutions



Source: (Rodríguez & Gómez, 2014)

Another important study showing evidence and data relevant and recent is from Boris Petkov (2018). In here, the author places the references of countries in both cases with natural resources but separating them between the ones that escaped from that trap and the ones who have not. The relation or the big difference is the amount of savings of that exploitation of resources the developed countries have and that poor countries lack of.

Resource adjusted saving rates (%GNI), average 1972-2000

Countries claimed to have escaped the resource curse		Countries claimed not to have escaped the resource curse	
Australia	18.0	Algeria	6.11
Botswana	33.0	Congo	−11.9
Canada	15.7	Mexico	10.80
Chile	7.4	Nigeria	−22.0
Ireland	22.0	Saudi Arabia	−21.5
Malaysia	19.9	Sierra Leone	−1.8
New Zealand	18.4	Trinidad and Tobago	−3.9
Norway	17.0	Venezuela	−1.8
Oman	−26.6	Zambia	−5.8
Thailand	20.0	Ecuador	n.a.
USA	15.1		

Source: (Petkov, 2018)

Applied to case studies, one of the most studied countries in this matter is Nigeria, due to its bad performance on development and the crisis that harmed that country specially after the 1970 and 1980 decades, when oil prices raised so much, increasing the rents inside the country and causing a crisis all over the world. These effects came back with more strength to shock the oil producing countries with bad institutions or those who strongly depended on oil. The matrix study for this topic is the paper from IMF written by Sala i Martin and Subramanian (2003), focusing with more attention on Nigeria and other oil producing countries.

	Nigeria	Oil producing countries	Developing countries	All countries
Per capita GDP, PPP, 1998	955	3,579	2,076	3,029
Growth rate of per capita GDP, 1960-98	1.336	1.105	1.520	1.739
Standard deviation of growth of per capita GDP	0.1465	0.111	0.078	0.0703
Coefficient of variation	0.110	0.101	0.051	0.040

Source: (Sala i Martin & Subramanian, 2003)

In the table, the comparisons of Nigeria to other countries is strong evidence of how even though they had lots of demanded resources like oil, the lack of institutions made them go terribly wrong. Besides accepting that some other oil producing countries did better, revising some other cases in different stages could help to support the evidence of lack of institutions in the management of them.

Findings and Analysis

As a brief summary of what the literature review can show us as a path, this essay finds evidence of the relation between the bad performance of wealthy countries in terms of natural resources, and special attention to the institutions, rule of law, and conflicts among them. One of the main hypothesis is that the abundance of natural resources tends to bad policies because of the interests implied and the sources of power over the resources. The evidence presented against this idea is the one that implies how some countries had natural resources and were able to use them in favor of development and did not find the impediments of bad institutions. The rebuttal against that idea is that these countries such as Norway or Australia, developed these good institutions from before and the administration of these resources was not something new.

Recalling the main argument of this paper, countries finding natural resources before the liberal democracy and the implementation of the rule of law, have governments with harmful decisions on using these resources on ways that do not contribute to the development of the country. Using these resources as a source of secure income and protecting them from foreign industries is one of the most harmful decisions from these actors since they make them inefficient without competition and exclusively because these are out of market relations existing only with subsidies and in uncertain amounts.

The idea is that if a country that had a predatory or weak democratic State before the finding of the resources, rent seeking activities and economic nationalization tend to be the solution or the trendy way of taking advantage of them. By these means, it is not necessary to separate between hybrid-democracies, dictatorships and predatory states, but only accepting that none of the mentioned conducts to a free market nor democratization of natural resources.

List of top 10 oil producing countries

Country	Million barrels per day	Share of world total
United States	14.46	15%
Saudi Arabia	12.08	13%
Russia	11.18	12%
Canada	4.87	5%
Iran	4.67	5%
Iraq	4.48	5%
China	4.45	5%
United Arab Emirates	3.71	4%
Brazil	3.29	3%
Kuwait	2.93	3%
Total top 10	66.12	69%
World total	95.36	

Source: (EIA, 2018)

A brief look-up on the oil producing countries, lets us know that most of them have strong dictatorships in which the oil reserves are owned by the State or by the monarch. Some years ago, Venezuela was part of that group, above Kuwait, and we could even argue that the fall of Venezuelan democracy was partially caused by the management of its oil reserves.

As happened in Central America in the XIX Century, some differences can be seen between El Salvador, Guatemala and Costa Rica when the three countries were producing an exporting coffee. The main reason of why Costa Rica reached a better performance in terms of development than El Salvador and Guatemala is on the details of how elites were organized and their relation with State. In Costa Rica some reforms on land ownership permitted the growth of a very competitive market of coffee while many different territories were divided in many small lands while in Guatemala and El Salvador, the preference was to insists in the "*latifundios*" method, consisting of huge amounts of land for some owners who were able to create more wealth with scale economics and exploitation of workers inside the farms. These different decisions were taken because in Costa Rica the merchants were the dominant elite while in Guatemala the landowners were still the main agents (Vahabi, 2017).

The same thesis supported for Guatemala and Costa Rica differences explains -adding Colombia to the equation- that the role of military power was very important in these actions. The military was very strong Guatemala and El Salvador and it was not enough strong in Colombia and Costa Rica, which permitted to the elites to have more forced control of their lands in Guatemala due to the strong fusion of State and economic elites, and did not happened the same in Colombia and Costa Rica.

Something similar happened in the case of Brazil, one of the largest economies in the world. During the age of modernization and prosperity, the Brazilian State was strongly controlled by the south-eastern elites of the country, something that is present nowadays. At the same time Central America competed for the exportations of coffee, Brazil was one of the biggest producers. The elites of coffee and herd created strong economic elites in the states of Sao Paulo and Minas Gerais, states that during the creation and design of a new Republic, would dominate the political panorama of Brazil. The phenomena later called *café com leite* (coffee with milk) promoted a precipitated and huge development of both sectors and created certain dependency on Brazilian economy, that would later stagnate for years the modernization of industries and new commerce in the nation until the revolution on the 1930 .

Something demonstrated with the examples previously given is that they propose that the bad policies towards natural resources are driven in both cases of pointy and diffuse resources. Plenty examples and research on oil are clearly pointy resources problems and conflicts. However, the examples of agriculture of Central America and Brazil are another view of the waste of natural resources in the diffuse way. The resources might be fertile land, abundant water, etc., but both examples tell us how the finds of these can become on a powerful weapon for states to dominate the population and the resources as long as it gets rents from the wealth these create. Latin America is regularly excluded of these analysis because in the literature, the Natural Resource Curse is only addressed in pointy resources, but the same logic can apply to these diffuse resources.

Three main arguments or points are in this essay regarding the role of natural resources in the underdevelopment of countries. 1) Non democratic governments waste the resources because as long as they owned them, they do not participate in market activities nor market logics. 2) As long as the main resource of a Government comes from natural resources, these find low probabilities and interests on democratization, 3) States' protection to economic elites controlling natural resources leads to stagnation, and creates dependency on limited sectors.

On the first point, non-democratic governments usually owning the natural resource from a long time before, find there a safe rent on time that helps them to overcome with the expenditure on their will. This is why most of the management of those resources is wasted since the premise of trusting government as the best knowing for the allocation of resources is hard to proof an believe. The best and unfortunate example of this is the situation of Venezuela, in which the Chavist party was not afraid of delivering bad policies because the income was continuously coming from national oil. The first years of that government were still prosperous and trustworthy to people, but the same system was destroyed with that strength harming democratic constitutions and strengthening the military.

Second, The first point becomes a cycle because with their own money, governments do not feel nor are accountable to the people on where the money is invested. People feel less responsible to watch government's activity because usually is not the money took out of their own pockets like it is in modern states with wide taxation systems and bases. The price of not having a democratic government has high probabilities of failure, especially with governments owning many resources which economic policies are not market oriented.

Third, the States' protection to local economic sectors has proof of being both good and bad depending on its implementations. However, in the case of the agriculture sector based on natural resources, the probability of damage is very high. As some economic elites take advantage and confidence of Government, these groups require more and more benefits and protection. This is how many different countries developed bills such as the Coffee Law in Guatemala giving perpetual subsidies to those landowners on a very risky business that can have massive losses due to climate change, competition and other causes. The investment on these risky subsidies can also be seen as a waste of money that is not allocated by the government in other areas. The same happens with sugar sector which is highly protected by law with no competition inside the country. The protection to these sectors because of "national interest" causes inefficient behavior in them due to the lack of competition and also a permanent need of labor that they cover. The problem is not that they cover the need of labor but that government invests in them instead of investing in education, rising human capital or other industrial and technological sectors that could empower growth faster.

The main reason of why developed countries such as the ones in the European Union have these protection and do not have the bad performance is because: on one side, they have a big internal competition between countries and two, their economies do not strongly depend on these sectors. That is why these sectors are protected as a consequence of modernization rather than a cause for it.

The strong competition of elites for the natural resources stagnates the countries investing always on the same sectors and stopping them from developing more technologies or ways for development. As Acemoglu and Robinson say in “Why Nations Fail”: “The most important lesson is that extractive institutions (predatory or dictatorships) cannot generate sustained technological change for two reasons: the lack of economic incentives, and the resistance from the elites” (Acemoglu & Robinson, 2012).

Conclusion

There is no complete evidence that every single country with abundant natural resources will be a failed country and will remain stagnated in poverty, but the strong correlation of these aspects deserves attention. As a socio-economic approach, it is known that not finding an absolute law and condition, does not mean that all the possibilities should be discarded. Under a process-tracing study in many countries, amplifying these hypothesis could demonstrate that under certain conditions the abundance of natural resources can lead to bad policies, bad governments and underdevelopment.

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