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BREAKING THE CURSE IN AFRICA

Yes, the Resource Curse!

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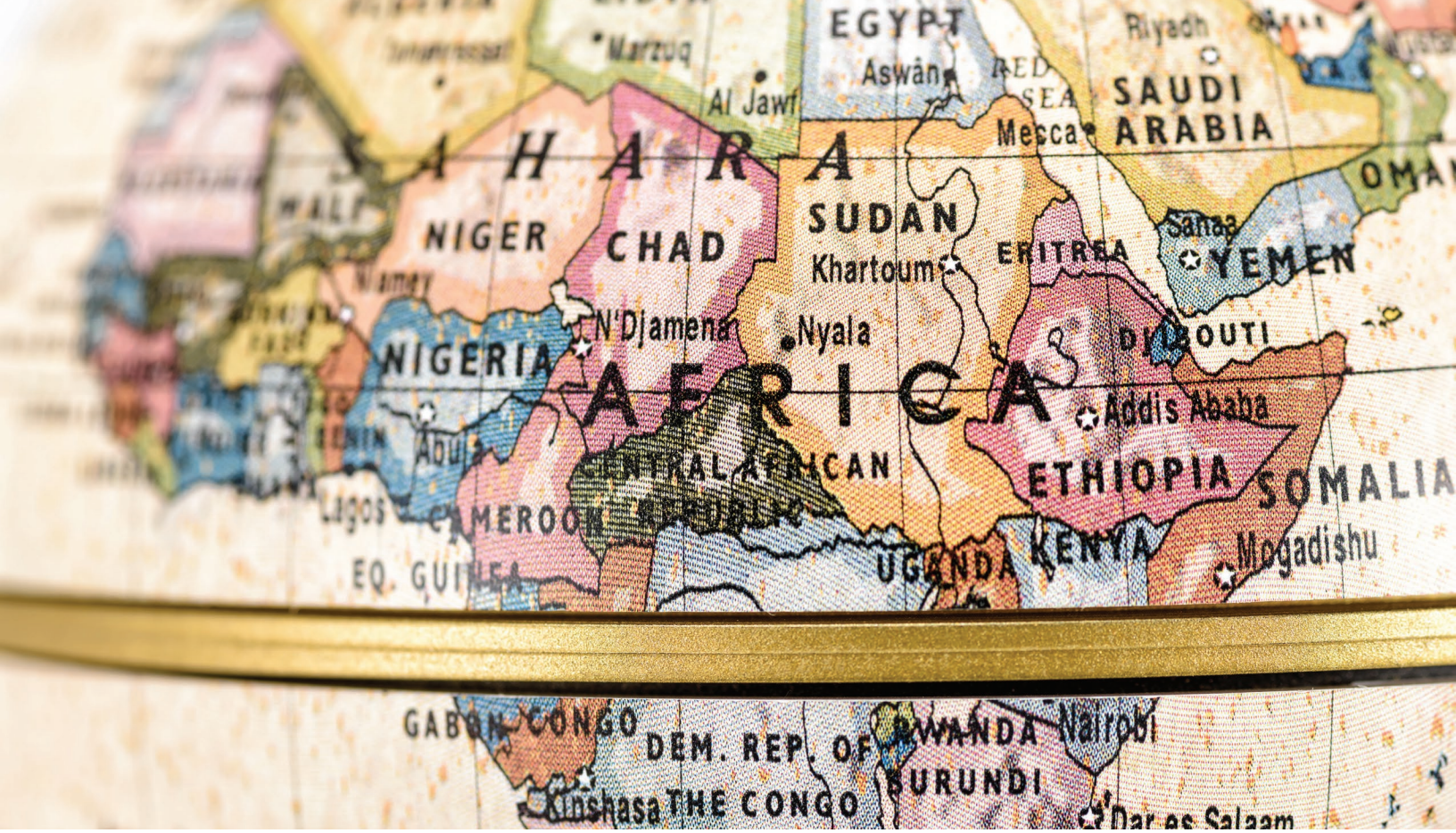

OUR REACH IS GLOBAL.
THE FOCUS IS AFRICA!

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1.0 BACKGROUND

DO NATURAL RESOURCES automatically lead to poor economic outcomes? Bingu wa Mutharika, economist and former President of Malawi, once said: Africa is not a poor continent; but the people of Africa are poor. Among others, modernization, dependency and the big-push theories explain economic backwardness in Third World countries.

Despite unprecedentedly high prices of natural resources in the past few decades, resource-rich jurisdictions are home to over 60% of the world's poorest people. Increasingly, the impact of natural resources on economic growth is a subject of intense debate. The fact that economies with little or no resources often do much better in terms of economic growth, compared to resource-intensive ones, remains a puzzle in development economics.

Many resource-rich African countries have little or nothing to show for their wealth. Sub-Saharan Africa, in particular, has become a classic case of the resource curse – the paradox that regions endowed with natural resources tend to have dismal economic performance. The curse has two common explanations in the literature: economic and political-institutional. The theory of Dutch disease is the major economic explanation of the curse;

a situation that leads to a diminished importance of the manufacturing sector due to the crowding out effect of natural resources. The political-institutional explanation, on the other hand, blames the existence of the curse on rent-seeking behaviour –often precipitated by the unpredictable nature of government revenues.

2.0 LEARNING FROM HISTORY

EXAMPLES ABOUND IN EXPLAINING how resource-poor jurisdictions often outperform resource-rich ones in economic growth. This, however, is not a generalization as there are many resource-abundant countries with very high economic growth rates. For instance, economic history reveals that resource-poor Netherlands did much better than Spain in economic growth despite the presence of gold and silver in the Americas where Spain had much of its empire in the seventeenth century (Sachs and Warner, 1997). Switzerland is one of the richest countries in the world today; this country depended on the financial and manufacturing sectors, and not natural resource extraction, in the quest for economic development.

The highly developed economies of the four Asian Tigers (Hong Kong, South Korea, Singapore and Taiwan) maintained exceptionally high growth rates and rapid industrialization between the early 1960s and 1990s which led to their transformation into advanced and high-income economies in the 21st century. The experience of all four countries shows that they specialized where they had a competitive

advantage. For example, Hong Kong and Singapore became world leading international financial centres, while South Korea and Taiwan became world leaders in information technology. This contrasts sharply with the situation in many resource-abundant economies such as Angola, Nigeria, Mexico and Venezuela where there is low standard of living, corruption, income inequality and civil disturbances – anecdotal evidence that natural resources may have a negative influence on economic development.

3.0 THE RESOURCE CURSE: TRANSMISSION CHANNEL

TRADITIONAL ECONOMIC THEORY emphasizes the role of resource endowment in the development process. In addition, contemporary studies in development economics increasingly recognize the importance of a strong institutional framework. This, they argue, defines incentives and penalties, shapes social behaviour and articulates collective action, thus conditioning development (Garcimartín, 2009). The complex and diverse experiences of the various countries mentioned above reveal that the various links in the resource curse are not deterministic as suggested by most of the available models on resource endowments and economic performance.

Botswana is one out of many developed and developing countries (e.g. Australia, Canada, Norway and Malaysia) that typify notable exceptions to the resource curse hypothesis. Since independence in 1996, Botswana has had one of the fastest growth rates in per capita income in the world – through heavy reliance on the mining sector. This has led to the transformation of Botswana from one of the poorest countries in the world to an upper middle-income country. This example clearly explains why it is hazardous to jump to the conclusion that all resource abundant countries are cursed; it suggests the need for giving a satisfactory explanation as to why resource abundance retards growth in some countries, while promoting development in others (Mehlum et al. 2006; Robinson et al. 2006). This reasoning has now paved the way for a critical examination of the channel through which natural resources impact economic growth.

Mehlum et al. provide an alternative explanation for the understanding of the resource curse through the argument that it is only when institutions are weak that resource abundance is harmful to growth. Their position is simple: countries with strong institutions do not experience the resource curse; they have

institutional quality strong enough to neutralize the curse. Gwartney et al. (2004) define institutional quality as an environment that is supportive of markets through property rights protection, enforcement of contracts, and voluntary exchange at market-determined prices – thereby supporting the institutional approach to growth. This is based on the notion that both the availability and productivity of resources are influenced by the institutional and policy environment. Easton and Walker (1997), Hall and Jones (1999), Aron (2000), Acemoglu et al. (2002) and Rodrik (2003), among others, have linked higher institutional quality levels to economic growth and income.

From the foregoing review, it is apparent that institutions matter in the analysis of the resource curse – since the problem has come to be identified as one in which poor institutional quality interacts with other variables to generate social and economic outcomes which are not Pareto optimal.

4.0 POLICY CONCLUSIONS

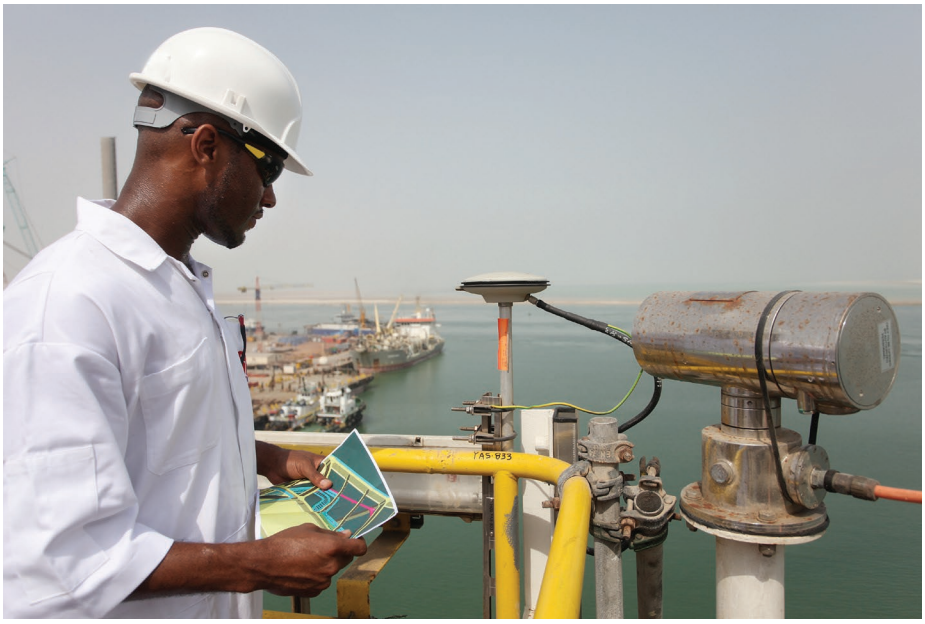
THE ANALYSIS SO FAR SHOWS that the resource curse does pose a challenge. Many papers have been written on this subject; we have no pretention of offering perfect policy solutions. What is important is that resource-rich African countries should come to terms with the fact that resource abundance is a double-edged sword, with both benefits and dangers. Canada is among the top ten oil producers in the world; this country has one of the least corrupt governments in the world. Its resource rents as a share of GDP is very low. The same is true for the United States, Norway and Australia. These facts establish one thing: Africa can escape the clutches of the curse.

Asked how Africa can escape the resource curse, an anonymous international development expert answered: replicate the Botswana model. However, history and experience tell us that the resource curse challenge must be addressed case by case. A country-specific strategy which recognizes that each region presents many nuances – with regards to key institutional, economic and governance issues – is the way forward. We suggest four policy solutions below.

A COUNTRY-SPECIFIC STRATEGY WHICH RECOGNIZES THAT EACH REGION PRESENTS MANY NUANCES – WITH REGARDS TO KEY INSTITUTIONAL, ECONOMIC AND GOVERNANCE ISSUES – IS THE WAY FORWARD.

First, the importance of good governance in transforming natural resource endowments into good economic performance cannot be over emphasized. Simply put, decision makers should not see rents from natural resources as a source of finance for major public initiatives and recurrent expenditures; they should learn from countries that succeeded in escaping the curse by channeling resource rents towards productive investments.

The adoption of transparency-related policies is closely tied to the point raised above. For instance, the Extractive Industries Transparency Initiative (EITI) is a major international initiative that enforces transparency in resource-rich countries' extractive industries. Ironically, while a number of African countries have joined, many have not yet joined the EITI. Over time, prudence in the application of the



EITI principles of transparency and accountability in the management of extractive industries can be expected to help find the path of success by avoiding the pitfalls that have afflicted many resource-endowed economies.

We turn to another key policy solution: diversification. Economic diversification remains a potent cure because a policy mix that reflects differences in economic structure can help African countries handle the disruptive effects of business cycles –by discouraging dependence on resource rents.

Last but not least, the importance of securing key stakeholders' cooperation in order to escape the curse cannot be overemphasized. Rejecting comments by the UK Prime Minister during a recent anti-corruption conference in London – that his country is "fantastically corrupt" –Nigeria's President Muhammadu Buhari said he did not want an apology from Prime Minister David Cameron, but instead Britain should help in the recovery of stolen assets held in British banks by corrupt officials and businesspeople.

The above example shows the importance of collaborating with relevant stakeholders in order to

REJECTING COMMENTS BY THE UK PRIME MINISTER DURING A RECENT ANTI-CORRUPTION CONFERENCE IN LONDON – THAT HIS COUNTRY IS "FANTASTICALLY CORRUPT" –NIGERIA'S PRESIDENT MUHAMMADU BUHARI SAID HE DID NOT WANT AN APOLOGY FROM PRIME MINISTER DAVID CAMERON, BUT INSTEAD BRITAIN SHOULD HELP IN THE RECOVERY OF STOLEN ASSETS HELD IN BRITISH BANKS BY CORRUPT OFFICIALS AND BUSINESSPEOPLE.

address the resource curse syndrome. In particular, the following: governments in extracting and capital-exporting countries, multilateral financial institutions, donors, private financial institutions, civil society and multinational mining, oil and gas companies. Multinationals have a huge role to play by helping in the strengthening of existing transparency rules, in addition to monitoring compliance and reporting defaulters.