# Resource curse and Dutch disease

What are the key problems that primary product dependency creates in each case?

## Case Study 1: Resource curse inflames W Africa suffering

It is no coincidence that the kind of horrors that Charles Taylor, the former Liberian president, is accused of perpetrating, and mineral riches, such as the diamonds he is accused of plundering, are often found together.

West Africa's soils groan with gold, ores and gems; they yield cocoa and timber in prodigious quantities.

They have also been suffused with blood spilt in pursuit of the mineral revenues that are often the only glimmer of wealth in a region beset by poverty.

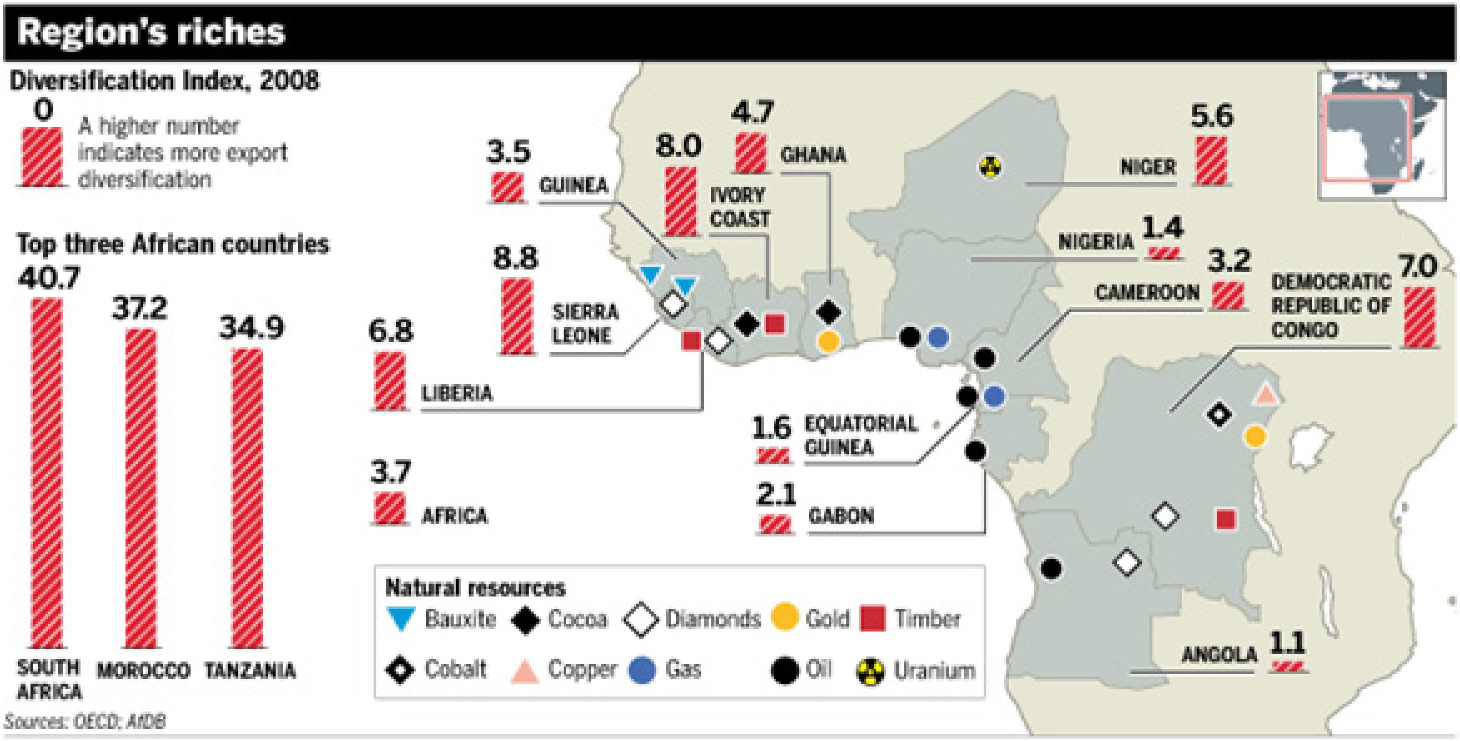
Mr Taylor denies 11 charges related to the 1991-2002 civil war in neighbouring Sierra Leone. Dramatic testimony from supermodel Naomi Campbell and others has yet to establish that Mr Taylor supplied a rebel group with weapons in exchange for diamonds.

But the prosecutors' argument goes to the heart of west Africa's woes. While the idea of a "resource curse" has its critics, for many analysts the child soldiers, sex slaves and severed limbs of Sierra Leone's war were the collateral damage of a scramble to control its diamond fields.

West Africa has since enjoyed a few years of fragile peace. But violence has plagued Nigeria's oil province and the fringes of the Sahara under which lie Niger's uranium stocks. Coups are also coming back into fashion.

What troubles many in the region is that the economic system that foments conflict shows little sign of changing.

"It's a general pattern in almost all west African countries," says David Zounmenou, a west Africa expert at the Institute for Security Studies in South Africa. "The economy is structured in such a way that the political elite will do anything to capture the state and control the resources."




Many of those economic structures have scarcely altered since independence, comprising a small elite composed of vying factions, a negligible middle class and a vast majority in the sprawling informal sector, farming, hawking or just somehow getting by.

In many countries minerals or oil account for 80 per cent or more of government income and an even bigger share of hard currency earnings. For disenchanted sections of the elite or the military, the prize can be irresistible.

February's coup against the authoritarian president of Niger added to a resurgent trend in putsches that appears to have tracked the boom in commodity prices. As a recent report by the African Development Bank and the Organisation for Economic Co-operation and Development noted: "Obtaining natural resource rents distracts governments away from more politically demanding forms of taxation."

Economists warn that the generally low share of income taxes in government revenue undermines the basic contract between rulers and ruled. Because they do not rely on the population for funds, governments feel scant obligation to provide basic services.

Instead, some analysts argue, governments are more bound to the handful of foreign mining or oil companies that fill the coffers – often under contracts shrouded in secrecy, allowing corruption to thrive.

Efforts to increase transparency have made some progress. The Kimberley Process, introduced after advocacy groups such as Global Witness documented the role of "blood diamonds" in Sierra Leone, has seen producers start to certify stones' provenance.

But few countries trapped at the bottom of the commodity chain have proved capable of converting their resource wealth into infrastructure that could engender a more diversified, stable economy. Even Nigeria, a key oil supplier to the US, fails to generate enough electricity to keep the lights on, let alone allow manufacturers to thrive.

Until that cycle is broken, the incentive for unrest looks likely to abide.

Said Djinnit, the senior United Nations official in the region, says: "When you are in the government you have access to power, to wealth; if you are excluded you have no access, you are excluded from wealth.

"In that sense it's a struggle for survival at the highest level."

FT Source: Tom Burgis, Resource curse inflames W Africa suffering, Financial Times /www.FT.com, 11 August 2010: https://www.ft.com/content/a45b9eea-a4a5-11df-8c9f-00144feabdc0

**Questions**

1. Why do resources lead to conflict? What examples are there?
2. What does the map suggest about the countries illustrated?
3. Why does it matter if natural resources form over 80% of a government's income?

# Case Study 2: Dutch disease

## Is Colombia Suffering Dutch Disease?

Despite the global economic situation, Colombia has shown resilience to external shocks in recent years, with reasonable economic performance in its region, in part due to responsible monetary policies conducted by the Central Bank. Capital inflows to the country have increased dramatically, mainly as a result of the exploitation of natural resources and the signing of several international free trade agreements. Additionally, the country has demonstrated political and monetary stability, which has generated investment scenarios desired by institutions and international investors. The high capital movements however, can have adverse effects on the domestic economy, making it necessary to maintain a responsible monetary policy to exert control over these phenomena.

But why might high capital inflows be undesirable in Colombia, or for that matter, in anyone's case? The influx of investment should, in theory, generate wealth for the country and increase its economic growth. These benefits will be realized in the short term, but if there are no policies governing these transactions, there will not be a positive effect in the long run. A significant increase in the country's income can negatively impact factors such as the trade balance, employment, the exchange rate's behaviour and the country's overall economic performance.

Foreign direct investment has rapidly increased in the past two years -- USD 6,889 Million in 2010 to USD 13,234 Million in 2011 -- and the Ministry of Trade and Industry announced a total of USD 16,683 Million for 2012. Disaggregating these figures by sector reveals an interesting pattern in their distribution and how they have shifted recently. Most FDI flows are targeted at the mining and oil sectors, with a total of USD 7,704 Million for 2011 and a total of USD 6,375 Million for the first three quarters of 2012, figure that is expected to rise well above last year's total.

What is the effect of these flows on the economy? As mentioned above, the short-term effects are positive, which is reflected in the significant increase in GDP for 2011. But the effects of this sudden increase in foreign direct investment begins to cause problems in the medium term for the country's economy, and may continue to do so in the long run if a way to fix it is not devised. The behaviour of the Colombian peso is undergoing a revaluation that is affecting the country's trade balance and limiting the competitiveness of its exports. The exchange rate of the Colombian peso against the U.S. dollar has risen by 21% against the $ over the last 5 years. As exporters receive their payments in U.S. dollars, this translates to less income in Colombian pesos, reducing their operating margin and making it harder to compete in the international market.

Excluding the mining and oil sectors, employment levels in Colombia are being adversely affected by FDI flows. Mining and oil generates only 1 percent of total employment in the country, while industry creates 13 percent and agriculture 17 percent. It is alarming to identify the disaggregated composition of the total gross domestic product for the third quarter in 2012, where sectors such as industry (-5.80 percent), construction (-31.15 percent) and financial institutions (-2.38 percent) show considerable contractions against the previous year for the same period. The country's main exports are being sectored; while mining, oil and gas sectors are increasing in an inversely proportional fashion to other sectors.

Coffee exports have declined USD 487 million from the first three quarters of 2011 against 2012 -- equivalent to a decrease of 23.2 percent -- while the oil and derivatives sector has increased by 12.3 percent for the same period. In fact, this detrimental effect of FDI flows and the subsequent decrease in coffee exports has led to a nationwide strike in the coffee sector that resulted in the granting of subsidies by the government. This has not only affected coffee, but also other economic areas that are entering into what has been considered by some as "the agro crisis", referring to the agricultural sector as a whole and its continuous decrease in productivity, exports and earnings.

All this refers to what is known in economic literature as the Dutch Disease, or in more technical terms as economic specialization. It refers to a distortion in the economy, where inward flows are concentrated on a single sector, making the rest of the economy suffer in real terms. In the specific case of Colombia, a spiking increase of investments has seen its way into the oil and mining sectors, generating positive effects in the short term but affecting the overall economy in the medium and long term. Symptoms of this longer term detriment are becoming evident: GDP is contracting, the Colombian peso is revaluing against the US dollar, job generating economic sectors are shrinking, traditional goods exports are decreasing, exporters are becoming less competitive, and the trade balance is contracting.

http://www.huffingtonpost.com/felipe-angel/is-colombia-suffering-the_b_3247265.html

**Questions**

1. Why did the Colombian peso appreciate?
2. How did this affect other exporters?
3. In particular what happened to the coffee sector?
4. Why were jobs created in growth sectors outweighed by jobs lost in other sectors?

# Case Study 3: Resource curse:

## How being located near mines hurts manufacturers

Producers of tradable goods close to areas of mining activity have lower sales because of infrastructure bottlenecks and competition for workers, but the revenue that mines generate improves the local environment for businesses. These are among the conclusions of research by Ralph De Haas and Steven Poelhekke, presented at the annual congress of the European Economic Association in Geneva in August 2016.

Their study combines European Bank for Reconstruction and Development (EBRD) and World Bank business data from 22,150 firms in eight countries with large manufacturing and mining sectors (Brazil, Chile, China, Kazakhstan, Mexico, Mongolia, Russia and Ukraine) with a geographical database of 3,793 mines producing 31 different metals and minerals.

The data show that many firms complain of competition with the mines for access to inputs, labour and infrastructure. They also experience congestion and infrastructure bottlenecks. Proximity to mining stunts their growth: moving a producer of tradable goods from a region without mines to a region with average mining intensity would reduce sales by 10% on average. Local firms that supply mines or use their outputs benefit, but they tend to be small enterprises.

The overall impact is negative, consistent with the theory of 'Dutch disease', in which resource booms drive up costs for firms in the traded (manufacturing) sector. On the other hand, mining revenue spent on goods, services and public goods in the region improves the business environment in a distance band of between 20km and 150km around firms.

The authors conclude: 'To minimise negative spillovers from mining, policy-makers could think about ways to let local producers share extraction-related infrastructure. Policy-makers can also help firms to become 'fit to supply' local mining-related supply chains.'

Adapted from:

http://blogs.lse.ac.uk/businessreview/2016/09/28/mining-causes-infrastructure-bottlenecks-that-hurt-nearby-manufacturers/

**Question**

1. Identify the main costs and benefits of locating a business in an area close to a mine.