The natural resource curse in 21st-century Latin America

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THE NATURAL RESOURCE CURSE: TOO MUCH OF A GOOD THING

The term "natural resource curse" (NRC) was coined a couple of decades ago to summarize the finding that, on average, developing countries that were highly endowed with natural resources were growing less rapidly than those that were less endowed. The finding was seen as counterintuitive—what could be more helpful to growth than an abundance of such resources?

Since the first study that presented the evidence, we have advanced considerably in our understanding of this "malady." First, we know that it does not afflict all natural resource–rich countries to the same degree. There is a wide range of growth experiences in such countries—wider than among the "unendowed" countries. Thus, the gap between the worst performers (Nigeria is often held up as a candidate for this dubious prize; Venezuela, since the 1970s, is another) and the best performers (Norway at the world level; Indonesia among developing countries) is very large. Second, we know a good deal about why it happens to those countries that fall victim. Third, we know that some natural resources pose a greater risk than do others, and we have some useful generalizations as to why this is so. Oil, gas, and most other mineral exports are dangerous, whereas exports of coffee produced on small farms are not.

> [D]eveloping countries highly endowed with natural resources had been growing less rapidly than those not so well endowed.

THE BIG PICTURE

We know that countries with large endowments of the "dangerous" natural resources are prone to unusually high levels of income inequality. Natural resource exploitation also frequently leads to environmental damage, long known to characterize much mining exploitation but also severe in the case of crops like soybeans. It also harms indigenous and other marginalized groups. This list of dangers underscores just how much damage the curse can do; at its worst, it deters growth, promotes inequality, is bad for the environment, and harms vulnerable groups in the society.

All of these threats should be of concern to Latin America. The region suffers from a chronically high level of inequality. It is now hopefully emerging from the worst quarter-century of growth in its statistically recorded history (from the late 1970s until the early years of the current decade), but the acceleration of the past decade has been substantially fuelled by natural resources, including oil, gas, coal, copper, and soybeans. Environmental damage and social injustice around the industries in question abound.

LATIN AMERICA'S RESOURCE FREE-FOR-ALL

The main mechanisms underlying the growth-reducing impacts of natural resource richness include:

- an excessive channelling of resources (political, human, physical, and other) to the fight for access to a share of the rents (easy incomes) that typically come with natural resource abundance (economists refer to this as a "zero sum" game, in which people compete for benefits in ways that do not increase the total income of the group, and may even reduce it);
- a lack of longer-term strategic planning, typical in economies that live off such resources; this is sometimes accompanied by lack of attention to education and the development of human capital; and
- a weaker-than-otherwise manufacturing sector, pernicious because this sector appears to generate more positive spillover effects on the rest of the economy than do the natural-resource sectors.

"THE DUTCH DISEASE"

Some of these effects are essentially political, including the pattern of conflict that arises around the control of these easy-income resources. Another, less obvious, aspect involves the "Dutch disease." In the absence of preventive policy, natural-resource export booms lead to an appreciation of the exchange rate relative to what it would otherwise have been, discouraging other exports and encouraging imports that compete with domestic production. Those other exports and/or import-competing goods involve manufactured goods, whose production is both more labour-using (thereby more conducive to equality) than the dangerous natural resources, and more growth-generating in other parts of the economy.

DEFEATING THE NATURAL RESOURCE CURSE

Wise governments can deploy a number of tools against the curse and wind up

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Governments . . . have to acquire knowledge and perseverance in pursuing other promising sectors to free a country from the "curse" and its distorting effects.

benefiting from nature's largess. One good policy is to exploit them gradually rather than quickly; since the impulse of the private sector, and all too often the public sector, is to get the profits as soon as possible, this policy requires self-restraint. Where exploitation is fast, it can be wise to hold some of the foreign exchange abroad (a strategy employed by Norway and, more recently, very successfully by Chile).

Another strategy is to make sure that the windfall profits or rents generated find their way into the development of other industries that will be competitive in the future. This involves an adequate rate of taxation of the private sector earnings and care that public sector revenues not be squandered on current political priorities as opposed to investment for the future.

One of the complexities of decision making in NRC countries is that, with exports of oil, copper, or soy dominating the comparative advantage hierarchy, it requires greater insight than in other settings to identify where future competitiveness will lie. One interesting strategy is to undervalue the exchange rate deliberately—as China has done so notoriously in recent decades, and as Chile did with great success from the mid-1980s, allowing many new potentially competitive tradeable goods to get a start, many of which later are able to withstand the eventual appreciation of the exchange rate. An ideal strategy is to use export revenues to foster competitiveness in labour-intensive activities, a policy most successfully pursued in Indonesia, which channelled oil revenues into the development of small-scale—mainly rice—agriculture.

WILL LATIN AMERICA TAME THIS BEAST?

How optimistic can we be about the next chapter of the NRC saga in Latin America? On the plus side, an increasing number of countries have technocrats who understand the issue and are conversant with the historical record. Chile is the outstanding example at this time. Colombia's Planning Commission as far back as the mid-1990s worried about the effects of a major new oil field, and brought in people knowledgeable about Indonesia to share their experience. Of course, such awareness is easily lost between administrations.

Another encouraging pattern in Latin America is a decline in income inequality in several countries, including Brazil, Mexico, and Peru. It remains to be confirmed that this is a real and lasting trend and, if so, to identify the mechanisms behind it, but it is nonetheless good news. It may mean that NRC effects will not push inequality as high in the future as in the past. On the negative side, the market-friendly revolution of economic policy beginning in the 1980s has restricted the government's role in most countries of the region, and yet a country in danger of the resource epidemic does need certain well-chosen forms of intervention to constrain market forces. Chile's use of the exchange rate to protect nascent industries and its practice of saving abroad exemplify how a modest amount of the right sort of intervention can bring very positive results.

WHAT OF THE FUTURE?

What of the winds of political change blowing through much of Latin America in the form of left-leaning governments? Such governments should be expected to attach more weight to employment creation and the distribution of the fruits of natural resource exploitation than have their predecessors, and to be less worried about intervening in markets. Much will depend on whether they have the technical expertise and political space to intervene the right way. Governments that understand the recipes for healthy job creation and the nature of the NRC challenge to such creation are likely to do much better than those that do not. NRC countries always face a challenge in creating enough decent jobs because the problematic natural resource exports are not only weak themselves in this regard, but also crowd out other tradeables sectors that are more employment-generating. Governments must be aware of this danger, and be able to ascertain its quantitative dimensions. They have to acquire knowledge and perseverance in pursuing other promising sectors to free a country from the "curse" and its distorting effects. This can be a very tall order.