



## Breaking the resource curse: Transparency in the natural resource sector and the extractive industries transparency initiative



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### ABSTRACT

This article critically examines the impact, up until 2009, of the Extractive Industries Transparency Initiative (EITI). The EITI is an international policy intervention that aims to mitigate the negative effects of resource abundance by promoting the transparency of resource revenues and accountability of the governments of resource rich states. Its effectiveness can be assessed by examining two outcomes that are suggested to be negatively affected by resource abundance: economic development and quality of governance. Through a panel study, including approximately 200 countries, the influence of the EITI in these two areas is examined. Results suggest that the negative effect of resource abundance on GDP per capita, the capacity of the government to formulate and implement sound policies and the level of rule of law is mitigated in EITI countries. However, the EITI has little effect on level of democracy, political stability and corruption. The study concludes that there are some early indications that the EITI has been successful in protecting some nations from selected elements of the resource curse. This is encouraging given the relatively short time period since the founding of the EITI, however the mixed results suggest that a similar study should be repeated in 5 to 10 years when EITI policies have had enough time to fully take effect.

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### Introduction

Natural resources have been sought after and fought over throughout history. They invite conflict due to their scarcity as they are highly valued yet unevenly distributed, given the varied geographic concentration of nature's bounty. Although this maxim is true to varying degrees depending on the particular natural resource in question, it has been frequently observed that the possession of these valuable resources often leads to negative development rather than the positive benefits that would be intuitively expected to accrue to the people and places that are so endowed. This phenomenon has come to be referred to as the "resource curse". Arguably, the resource curse is not always inevitable, and many aspects of society beyond simple resource abundance have been examined as other possible factors in determining whether a country will experience such negative effects. Transparency and accountability within government are potentially among the key determinants of the economic, political and social consequences of natural resource abundance.

With this paradigm in mind, among other campaigns, the Extractive Industries Transparency Initiative (EITI) has been established to increase transparency and accountability in resource-rich

states in order to counteract the negative effects of natural resource abundance that have been observed. The EITI has had success in recruiting resource rich countries to become members. At the time of writing, 33 countries had either been designated as candidates for EITI compliance or were already compliant, 21 of which are Sub-Saharan Africa. This article asks the question: Has the EITI been effective in mitigating the "resource curse"? Effectiveness is assessed by examining two outcomes that seem to be negatively affected by resource abundance: (1) economic development, and (2) the quality of governance. The next section of the paper explains why these two outcomes are key elements of the resource curse. The concepts of transparency and accountability are examined in detail given their prominence in the goals of the EITI.

An examination of the EITI's goals and the role of transparency and accountability within the initiative are discussed in the third section of the article. These factors are fundamental to the argument that EITI membership can be used as a proxy measure of willingness to reform institutions (i.e. increase transparency and accountability). As institutional quality has been found to be a determinant in whether a country is affected by the resource curse or not, membership is thought to improve institutional quality and therefore magnify the factors that are negatively influenced by the resource curse.

The remainder of the article is devoted to providing an empirical study of the EITI's effectiveness in terms of economic

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development and governance. This is accomplished using panel data from approximately 200 countries from the years 1995 to 2009. The results illustrate the expected negative effects of natural resource abundance on economic and governance outcomes but the evidence of EITI membership moderating this effect is mixed. Although results indicate that that EITI membership is associated with a significant decrease in the negative effects of resource abundance on *GDP per capita*, *government effectiveness*, *regulation quality* and *rule of law*, weaker and inconsistent improvements from the EITI were seen in *control of corruption* and *voice and accountability*. Unfortunately, the EITI membership had no significant effect on *political stability/no violence*. Results also vary to some extent depending on which indicator for natural resource abundance is used. Equally puzzling is that the EITI membership itself had a negative effect on most of the outcomes. These adverse findings may be the result of other factors such as negative selection of countries asked to join the EITI, a lack of time for implementation, the complicated nature of the EITI membership process and/or actual problems with the effectiveness of the EITI. The article concludes that taken as a whole, there are some early indications that the EITI has been successful in mitigating certain aspects of the resource curse. More research, however, is needed to evaluate the EITI's influence in the long run, allowing more time for benefits to take effect.

## The resource curse: A literature review

### *Natural resource effects on the economic development*

#### *The debate*

The resource curse debate originated as a theory based mainly on the economic effects of natural resource abundance. [Sachs and Warner \(1997\)](#) demonstrated that countries with abundant natural resources tend to grow more slowly than countries without large quantities of natural resources. In their research, they suggested that the main reason for the negative growth effects observed is Dutch Disease. However, many questions remained as to why some countries with large quantities of resources tend to do well economically, while others, with similar natural inventories, tend not to perform as well. Complicating the debate is the secondary question of just how the natural resource sector within a country should be quantified. Indeed, depending on how the measurement debate is resolved, this quantification could determine if the resource curse actually exists.

[Sachs and Warner \(2001\)](#) argued that looking at the concentration (intensity) of resource abundance in a country is more important than examining the gross quantity of resources per capita given that a high concentration (intensity) often results in a strong 'crowding out effect'. As such, they opted to use natural resource exports as share of GDP. However, [Alexeev and Conrad \(2005\)](#) challenged this, countering that measuring natural resources in terms of the ratio of exports to GDP is flawed. They argue that more developed countries would consume more of their resources domestically, diluting the measurement of resource abundance made by [Sachs and Warner \(2001\)](#). Furthermore, they argue that because they are examining the effect of resources on GDP, measuring resources in term of it share in GDP is flawed. They instead measure per capita oil and mining output. They find that when adjusting the empirical measurement and methods, specifically for the overuse of the growth rates as an indicator and measuring resources as shares of GDP, there does not appear to be any resource curse for oil.

[Sala-i-Martin and Subramanian \(2003\)](#) disaggregate the [Sachs and Warner \(1997\)](#) measure and differentiate between point source resource exports (fuels and metals) and agricultural and

raw materials. They find none of these exports have a direct effect on growth, but find that point resources did have a detrimental effect on growth through their effect on institutions (discussed more fully below). [Isham et al. \(2003\)](#) also distinguish between exports and find that point source and plantation exports negatively affected institutions, which in turn affected a country's ability to deal with price shocks, ultimately affecting prosperity. [Leite and Weidmann \(1999\)](#) went further and deconstructed the natural resource exports as a variable for their study looking at the connection between corruption and natural resources (however, [Alexeev and Conrad \(2005\)](#) still argue that all of these findings are questionable due to the use of a GDP as a control variable).

#### *The role of institutions*

The strength and quality of government and societal institutions are a possible explanation for why some countries succumb to the resource curse while others seem to benefit economically from their natural resources. The success of resource rich countries such as Botswana and Norway has prompted scholars to investigate the protective role institutions might play in determining whether countries fall victim to the resource curse. [Mehlum et al. \(2006\)](#) find that resource abundance only affects growth rates negatively when institutions are weak. In contrast to [Sachs and Warner's](#) work, countries that are over the threshold for high quality institutions, as defined by the authors, do not experience the negative impact of the resource curse. In addition, [Sala-i-Martin and Subramanian \(2003\)](#) find an indirect link between growth and natural resources with respect to institutional quality. They find that natural resource abundance has a negative effect on institutional quality and that institutional quality has an impact on growth. However, once institutional quality is controlled for, there is no effect due to natural resource abundance on growth. However, these findings only apply to "point source" resources such as fuels and minerals.

[Boschini et al. \(2005\)](#) refer to the interaction between institutional quality and the type of resource as "appropriability". Alluvial diamonds, for instance, are highly appropriable products, while most agricultural products have a low appropriability. The more appropriable a resource is, the more important the interaction with institutions. [Boschini et al.](#) conclude that "sufficient improvement in institutional quality turns resource abundance into an asset rather than a curse" (27–28).

[Robinson et al. \(2006\)](#) look at the effect of resource booms in a society. In countries with weak institutions, where politicians may turn to clientelism and tend to discount the future because of their reduced chances of remaining in power, resources will often be extracted too quickly, resulting in a boom, which in turn renders the politician even more inefficient and distorting the economy even further. When occurring in the presence of robust institutions, however, resource booms will raise national incomes.

This section of the paper has identified two main factors in determining the extent to which a country can suffer *economically* from the resource curse. One is the abundance of natural resources within a country and the other is the quality of its institutions. Since a country has little control over the quantity of resources with its borders, the quality of institutions is, therefore, the most critical determinant of outcomes. The next section of the paper will examine ways in which resource abundance can influence governance directly and draw attention to why building strong institutions in resource abundant countries could be a daunting but necessary task requiring outside assistance.

#### *Natural resource effects on governance*

It has also been suggested that a country's governance suffers directly from natural resource abundance. For instance, [Collier \(2007\)](#)

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