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# Why Do Some Oil-Producing Countries Succeed in Democracy While Others Fail?

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**Summary.** — Empirical studies examining the effect of oil on democracy have shown contradictory results. This paper offers an explanation. In measuring the number of years between the beginning of oil production and the attainment of political independence in oil-producing countries, we found that the greater the number of years, the higher the level of democracy *ceteris paribus*. The types of resources exploited in the colonial period were shown to have influenced institutions' nature and the formation of elite, which acts to prevent subsequent political reforms. This pattern is mitigated in countries that started producing oil far away from their independence.


*Key words* — oil resources, economic history, democracy, economic development

## 1. INTRODUCTION

Democracy is one of the main controversial topics in the literature on the resource curse. Indeed, since the work of Ross (2001), demonstrating that oil is negatively correlated with democracy, several studies have tested this hypothesis with mixed, and even contradictory, results.

Studies supporting Ross (2001) include Jensen and Wantchekon (2004), who show that oil and mining countries are the least democratic countries in Africa, Tsui (2010), who exploits the variation in the importance of oil discoveries and finds a negative effect of oil on democracy, and Aslaksen (2010), who shows that the negative effect of oil on democracy is robust to the inclusion of fixed effects. However, these studies are contradicted by results from, for example, Herb (2005), who uses counterfactual analysis and finds no oil effect on democracy, and Haber and Menaldo (2011), who use panel co-integration techniques and find no evidence on the negative effect of oil on democracy.

While these differing results are interesting, the key factor, as underlined by Torvik (2009), is not the average performance of a group of countries *per se*, but why particular countries producing the same natural resource succeed as democracies while others fail. Why does a country such as Ecuador exhibit better functioning democratic institutions, while a country such as Qatar remain undemocratic (see Marshall & Jaggers, 2002)? The current literature, which consists of studies simply comparing the performance of oil-producing countries with that of non-oil-producing countries, does not provide answers about the differences in institutional performances between these oil-producing countries. This paper attempts to fill this gap.

Thus, for oil-exporting countries, this paper highlights one key feature that affects their contemporary democracy level. Current democracy in oil-producing countries tends to be positively correlated with the length separating the date of the beginning of oil production from the date of a country's political independence. More explicitly, if T-production is the date of the beginning of oil production in a country, and T-independence is the date of this country's independence, the higher the number of years from T-production to T-independence, the more likely this oil country is democratic in comparison to other oil-producing countries *ceteris paribus*.

Our work builds upon Omgba (2014) who found that the aforementioned length of time positively affects export diversification patterns in oil-producing countries. This paper supports the finding that the most important point is not the length *per se*, but rather the institutional dynamics that this length represents. The institutional dynamics investigated in this paper concern the dynamics of political institutions. Indeed, among formal institutions [1], one can distinguish economic institutions from political institutions, with the former defining the rules for human interaction in the economic field (e.g., property rights), and the latter, including democratic institutions, defining these rules in the political arena (Acemoglu, Johnson, & Robinson, 2005).

Among the components of democratic institutions, the accountability of politicians vis-à-vis their constituents and the citizens' ability to participate in selecting the government are accounted for (Acemoglu et al., 2005). The explanations behind the results of this paper might be grounded in these particular components of democracy. Indeed, the paper states that the type of resources used in the colonial period influenced the nature of the political institutions created by settlers, which were maintained after independence because they benefited the national political elites in power in these countries. This pattern is mitigated in countries that began producing oil much after independence, as citizens developed more competence in mobilizing and representing, which has allowed them to challenge the elite.

Indeed, a major strand of the development literature supports the claim that resource endowment determines the type of colonization (Acemoglu, Johnson, & Robinson, 2001; Engerman & Sokoloff, 1997). There are two main types of colonization: settlers' colonies, in which inclusive institutions have been established, and extractive colonies, in which extractive institutions have been transferred. This paper extends this analysis by arguing that the extractive colonies vary depending on the type of exploited natural resource, and that this vari-

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ance affects the current performance of democracy in oil-producing countries.

The remainder of the paper is organized as follows. Section 2 reviews the literature on resource abundance and institutions and provides theoretical arguments that help to interpret the empirical results presented in Section 3. Finally, Section 4 concludes and draws policy implications.

## 2. LITERATURE REVIEW AND THEORETICAL ARGUMENTS

### (a) *Resource curse: a curse of Institutions*

Early explanations of the resource curse highlight two effects: Dutch disease and the volatility of commodity prices. A boom in a sector producing a natural resource leads to an increase in the price of non-tradable goods. Since the price of tradable goods is determined on the international market, then there is an appreciation of the real exchange rate leading to a loss of competitiveness for the whole economy: this is Dutch disease (Corden & Neary, 1982).

Moreover, resource-dependent economies are more vulnerable to price shocks. These price shocks induce instability of the latter. This price volatility implies revenue instability and fuels expenditure instability. The instability in spending is even more damaging than the adjustments are asymmetric (*ratchet effect*). Expenditures are easy to breed during the period of rising prices, but they are difficult to adjust during the period of falling prices (Collier & Gunning, 1999). In addition, this instability also affects the investment decisions of private agents, and therefore the growth of the countries. Budina, Pang, and Van Wijnbergen (2007) speak of implicit tax on investments, including fixed capital. Indeed, investments require making irreversible decisions, which are difficult in unpredictable and uncertain environments, such as an environment dominated by instability. In addition, Aghion, Bacchetta, and Ranciere (2006) note that the effects of instability are much more pronounced in countries with underdeveloped financial systems; this is the case in developing countries. In this context, the hedging risk is insufficient. Consequently, these countries will suffer the brunt of the effects of instability.

However, these explanations in terms of Dutch disease and volatility do not explain the variance in performance of countries with natural resources, since all resource-producing countries do not perform equally when they are subject to similar price shocks (Torvik, 2009).

Indeed, revenues from natural resources may instead be the prey of the predatory elite (voracity effect). The pioneering work of Tornell and Lane (1999) establishes the voracity effect of elites. The authors argue that in a resource-rich country, the presence of several interest groups can reduce growth, as an increase in revenue from exploitation of the resource leads to pressure to increase transfers to each group. This increase in public spending is oriented toward non-productive activities, which further leads to a reduction in the productivity of capital, and ultimately a decrease in growth.

Sala-i-martin and Subraamnian (2003) and Budina et al. (2007) provide empirical evidence for this voracity effect in Nigeria, Africa's largest oil producer. For the authors, even if the effects of Dutch disease and volatility of oil resources may exist in the Nigerian economy, these effects are exacerbated by the greed of the Nigerian elite. Indeed, the oil boom of the '60 and '70s resulted in an increase in demand for direct transfers to elites from different states of Nigeria. Public expenditures of the central government have therefore increased. Rigidity for lowering these expenditures during the period of falling prices led to the formation of a debt burden that was profitable to elites, but fatal to the Nigerian economy (Budina et al., 2007). According to Sala-i-martin and Subraamnian (2003), Nigeria should have earned 350 billion U.S. dollars as cumulative net income over the period 1965–2000, but from 336 U.S dollars per capita in 1965, Nigeria painfully reached only 440 U.S dollars per capita in 2006 (WDI, 2008). These authors estimate that two-thirds of the amount of public investment has not been realized. The authors claim that this money has been hijacked by the predatory corrupt elite (Sala-i-martin & Subraamnian, 2003). Nigeria, therefore, appears in the literature as an illustration of the collapse of a country with natural resources (Van der Ploeg, 2011).

This predatory behavior from elites does not seem limited only to Nigeria. Gauthier and Zeufack (2011) show that, in the case of Cameroon, only 46% of total oil revenue accruing to the government during 1977–2006 may have been transferred to the budget. The remaining 54% are, as yet, unaccounted for.

Thus, institutional deficit and including governance may explain the performance of the economies of resource-rich countries. Even if, on average, natural resource-dependent countries have poor economic performance, recent examples of successful development based on natural resources can be found. For example, oil is considered a blessing for Norway, but a curse for Nigeria (Mehlum, Moene, & Torviks, 2006).

In general, the exploitation of natural resources causes two opposite effects. On the one hand, it increases the revenues of the country; on the other hand, it causes the displacement of private agents from the most productive sectors of the economy toward natural resource industries. This second point leads to the opportunity for rent-seeking behavior, as agents will therefore be subject to the tradeoff between using their resources for productive activities or using those resources for rent-seeking. The decision to shift from one activity to the other will depend on the profitability of each segment.

Mehlum *et al.* (2006) suggest that profitability will depend on the quality of institutions in place. Ebeke, Laajaj, and Omgba (2012) show that this reorientation of talent depends largely on the quality of governance. The quality of governance in resource-rich countries affects not only economic outcomes but also, more dramatically, the well-being of its citizens, including the effects of armed conflict (Collier & Hoeffler, 2000).

To this end, one result that has been put forward in the resource curse literature is that resource dependence positively affects the occurrence and the duration of armed conflicts (Collier & Hoeffler, 2000). According to Collier and Hoeffler (2000), in countries with economic growth and low per capita income, the presence of natural resources increases the risk of armed conflicts. The authors explain this regularity by the availability of funding, derived from the exploitation of natural resources and the prospect of the greatest return from the winner, from different groups. Indeed, war is costly; therefore, like any economic action, it is undertaken only in certain conditions, such as improving the welfare of the protagonists. However, groups who take up arms are not motivated by the public interest to alleviate the suffering of the majority; they are more interested in private gain. The availability of natural resources materializes the expected gains and provides these groups the means to launch and maintain armed conflict.

Ineffective governance, particularly lack of transparency, can allow rebels to fantasize about the amount of earnings, which facilitates the recruitment of militiamen. The formation of armed bands is made easier by the corruption of elites. Indeed, in countries with weak governance, money for the pro-