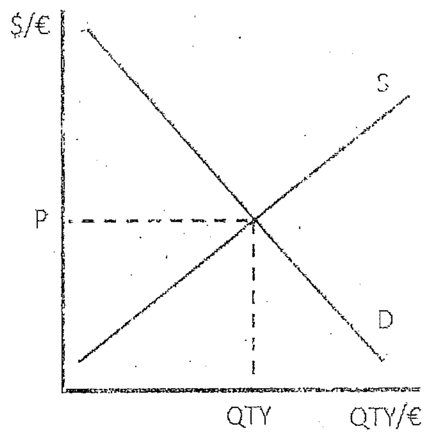
The curious case of resource-rich developing countries

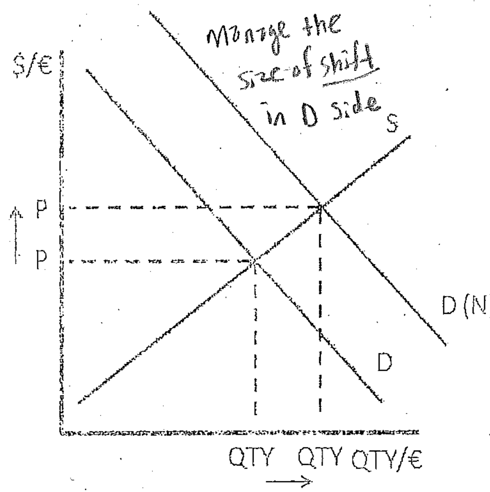
It is hardly a shocker that not every developing country has had the spectacular economic growth rates that China experienced in recent years, some developing countries are simply developing at a much faster pace than others. There are various reasons as to why some developing countries are doing better than others, think of for instance political (in)stability, economic policy, (a lack of) foreign direct investment and the competitiveness of an economy. In an increasingly globalized marketplace it is important that countries have something to offer if they were to attract foreign direct investment and develop. One could think of cheap labour or an attractive fiscal climate. Another factor that, on the surface, seems to stimulate economic development of previously underdeveloped countries is the availability of marketable natural resources, especially oil and gas. It seems that countries that are rich in natural resources have an advantage over those that are not when it comes to economic development, simply because they have something to offer on the market place. One is tempted to think that, if managed properly, an abundance of natural resources should enable economies to develop and lift millions out of (extreme) poverty. Reality however shows that resource-rich developing countries are not experiencing the economic growth that one would expect them to, mainly due to two phenomena that economists coined the *resource curse* and the *Dutch disease*. In the remainder of this lesson we will discover what these phenomena are and how they hamper the economic development of resource-rich countries and finally, you will brainstorm about what can be done to manage resource-rich countries better.

The Dutch disease

The first challenge that countries with an abundance of natural resources are facing is named after the country that experienced it first. In the 1960s and 1970s the Dutch discovered large oil and gas fields in the North Sea. It was only natural that they decided to set up a state enterprise to extract much of what was given to them by Mother Nature and invest the proceeds wisely in the economy in order for the economy to flourish for years to come. They figured that investing all that money in for instance infrastructure, education and health care would yield fantastic long term returns.

Reality however turned out to be a little different. The economy of the Netherlands slowed down in the years that followed the discovery of the oil and gas fields. Firms found themselves unable to compete in the increasingly international market place and unemployment rose steadily. It turned out that the seemingly wise investment plans that the Dutch had had come with an unexpected side effect that would later be coined the Dutch disease. The extraction and sale of oil and gas on the international commodity markets came with a huge influx of the currency that was, and still is, used on those markets: American dollars. The Dutch quickly converted those dollars into guilders, the currency that would allow them to carry out their domestic investment plans. As a consequence of this increase in demand for guilders the price for the Dutch currency rose considerably, as is illustrated in the figure below.





Why a problem in NLD (the nature of their economy)

Contributing factors to PROBLEM

☐ NLD strengthens: imports ↑ buy abroad, exports ↓

offshore demand drives economy (OPEN ECON)

NLD → export driven economy / export develop. model

→ NLD unimportant currency → low supply/demand, low # of historical transactions

→ small country

Tsunami of USD into small currency mkt.

Solutions

/ euro

/ less import dependent

/ investment fund abroad

As with any change in exchange rates there are winners *and* losers. In the case of the Netherlands in the aftermath of the oil and gas discovery consumers got more dollars for their guilders. It was suddenly a lot cheaper to see the Boston Red Sox play the Toronto Blue Jays at Fenway Park, although the ticket prices in Boston remained unchanged. On the other hand Dutch exporters of Gouda cheese faced a decrease in demand for their products as American consumers suddenly had to pay significantly more for the Dutch cheese and turned to alternatives.

At the bottom line the effect of the change in the exchange rates turned out to be negative, particularly because the Dutch have a very open economy. It got suddenly cheaper for consumers to import goods from the United States than to shop for domestic goods. In addition to that companies struggled more and more to compete on the international marketplace because of the strong guilder. The decline in both domestic and international demand for Dutch products and services ultimately hampered economic growth.

The Netherlands is not the only country that is prone to the Dutch disease, the phenomenon occurs as well in many developing countries. Can you suggest measures that would allow countries to mitigate the problem? Think about what you have learned about exchange rates.

SOL #1

Split betw domestic investment & Foreign investment

NOR OIL FUND

NORWAY SOLUTION - Stiglitz

1$ → 78¢ → 3¢ now - exchanged in NOR currency & spent / invested in economy

→ 75¢ later - STABILIZATION FUND, foreign investment fund managed by CB, carefully managed by gov't, NOR oil fund ↓ managed by central bank NORGES BANK

→ 22¢ private sector ↳ w/ resources & experience but GOVT remained in control ↳ NOR gov't direct ownership

DIVID: How fund is divided into focus - equity 60%, - fixed assets/income 35% (corp./govt bonds), - real estate 5%

example: easy to copy/duplicate in devel. world? How many resource revenues?

NORWAY
↳ small pop.
↳ export driven
↳ minor currency

cross over solution to developing countries who are resource rich

⇓

Would this work in developing context? Short termism vs luxury of longtermism

poverty

pol. stability / instability

corruption

pol. consensus

transparency

longterm stat.

ethical investing/resp. investing