Development, Foreign Aid, and the Resource Curse

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POLI 150

11 April 2024

Announcements

- Exam 2 on the 18th. Covers all material AFTER exam 1. 15-20 multiple choice questions, open-note, open-book. Opens at 12:01 AM on the 18th and closes at 11:59 PM. 1 hour and 15 minutes time limit. Can be taken from anywhere; no requirement to be in the classroom.

Today's Class

- LDC definition
- Causal factors of development
- Political economy of development
- Resource Characteristics
- The Resource Curse

Key Terms

- Less developed countries
- Import-substituting industrialization
- Export-oriented industrialization
- Official development assistance
- Resources
- Resource curse
- Dutch disease
- Rentier state
- Petrodollar system

Central Questions

Why are some countries less developed than others, and what can be done to change that? Are countries that have access to rare, exportable natural resources worse off than countries that don't have access to such resources?

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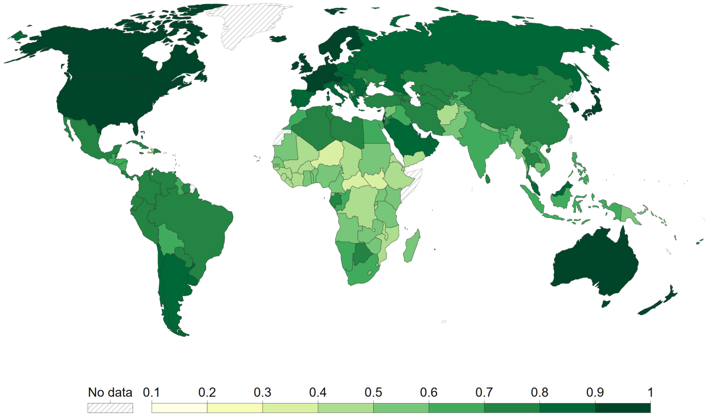
- As a policy goal, these states want to become more developed.
- While the goal itself is uncontroversial, the steps necessary to develop can cause some conflicts of interest.
- In particular, the paths to development often produce policy conflicts with **advanced, industrialized countries (AICs)**: those states at a high level of economic development.

HDI Across the World

Human Development Index, 2017

The Human Development Index (HDI) is a summary measure of key dimensions of human development: a long and healthy life, a good education, and having a decent standard of living.

Our World in Data

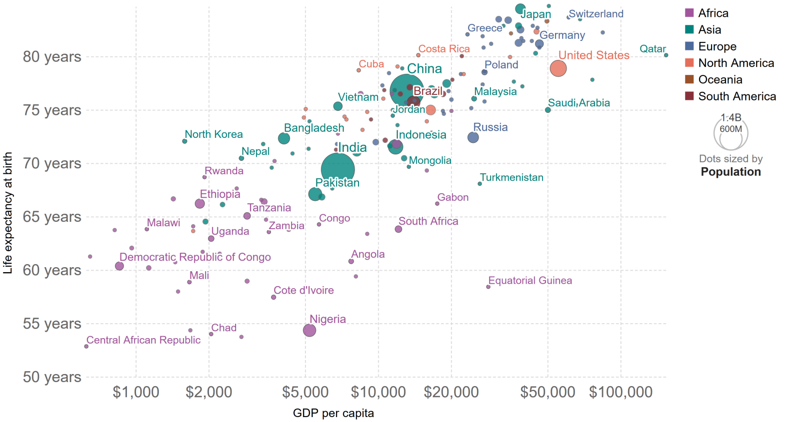


Source: United Nations Development Programme, Human Development Report 2020 OurWorldInData.org/human-development-index/ • CC BY

GDPpc and Life Expectancy

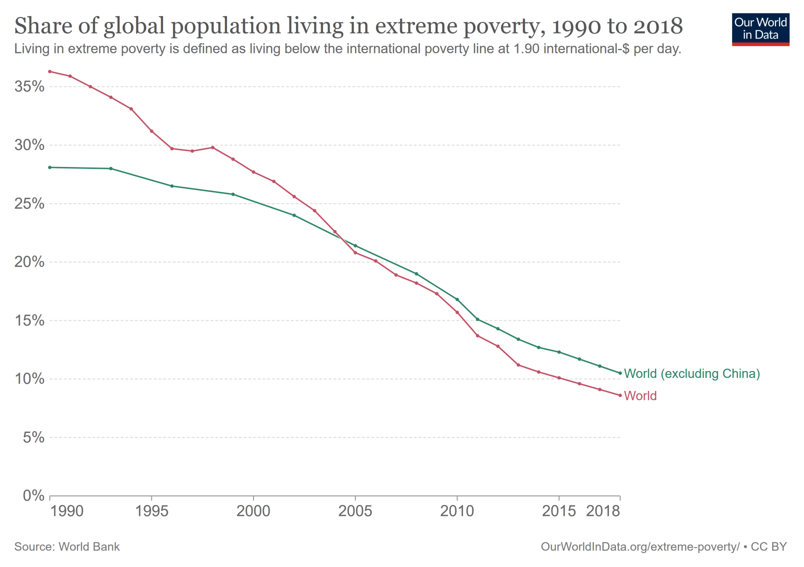
Life expectancy vs. GDP per capita, 2018

GDP per capita is measured in 2011 international dollars, which corrects for inflation and cross-country price differences.



Source: Clio-Infra & UN Population Division, Maddison Project Database 2020 (Bolt and van Zanden (2020))
OurWorldInData.org/life-expectancy •

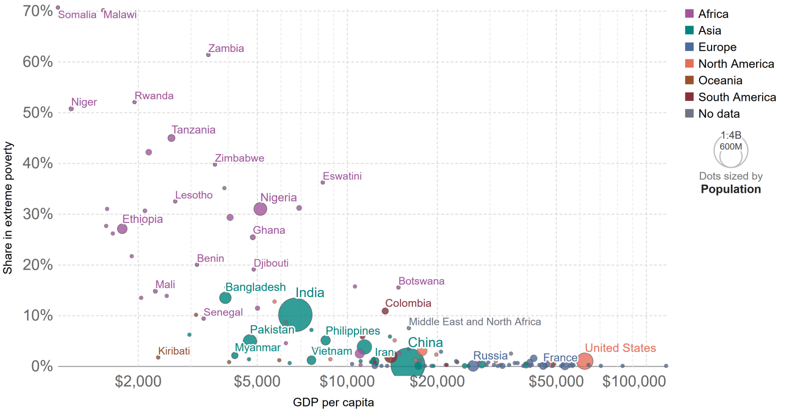
Global Population and Poverty



Poverty and GDPpc

Share of population living in extreme poverty vs GDP per capita, 2020

Extreme poverty is defined as living below the International Poverty Line of $2.15 per day. This data is adjusted for inflation and for differences in the cost of living between countries.



Source: World Bank PIP; World Bank WDI

Note: Poverty data relates to household income or expenditure, measured in international-$ at 2017 prices to account for inflation and differences in the cost of living between countries.

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- Not the same sectors as in Ricardo-Viner theory!

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- Advanced economies tend to focus the majority of their economic activity on the secondary and tertiary sectors.
- These categories are abstractions and generalizations of the economy: you can find specific counter-examples for any of them.
- So, what aspects of a state explain its (lack of) development?

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  - Weather
- All of these were argued to lead to less development.

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- Bigger problem: Huge variation in countries that are geographically similar.
- Ex: continued poverty in Zambia while Botswana has grown economically, despite similarly low levels of development at independence in the 1960s.

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- But many policies of colonialism did hamper development: mercantilist trade toward mother country, restricted colonial manufacturing, resource exploitation.
- To explain the difference in post-colonial experience, one must first examine the domestic determinants of growth.

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  - Lack of technical capacity, resources.
  - Lack of political will (e.g. conflict of interests between rural and urban areas).
  - Lack of strong government institutions able to do these things.
- One explanation for differing colonial outcomes was that European colonists set up different institutions in different areas.

Contestable Factors: Domestic Politics

- This argument, advanced by Acemoglu, Johnson, and Robinson (2001) and covered on pg. 440-441, says:
  - European colonists only established growth-enabling government institutions with strong property rights protections, which ultimately encouraged investment, in areas where they could settle in large numbers without facing disease or other mortality factors.

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  - In areas which were inhospitable to Europeans, they primarily set up extractive government institutions focused on siphoning wealth back to the motherland. These institutions, and this style of government, persisted after independence and sabotaged economic growth.
- **This account is largely discredited, based on methodological criticisms of the data analysis in that article, but the intuition has lingered.**

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- This policy came in two types: ISI and EOI.

Policy Option: ISI

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- Required substantial government involvement: trade barriers, government planning, investment policy choices.

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- But failures and imbalances appeared in the 1970s...
  - Current account deficits and unsustainable sovereign borrowing eventually led to financial crises (starting with Mexico in 1982).
- **More importantly, protected industries were not competitive once trade barriers were lowered.**

Policy Option: EOI

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- **Export-Oriented Industrialization (EOI)**: support domestic manufacturing with loans, tax breaks, and currency management while remaining open to trade.
- EOI was implemented during the 1980s, and (paradoxically) fit well with the Washington Consensus of the 1990s.

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- Eventually became the major recommendation in IMF conditionality.

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Verdict: effective for those first East Asian states that adopted it, but less likely to succeed today.

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  - This lowers world prices, making it impossible for LDC farmers to compete.

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  - WTO policy has lowered manufacturing trade barriers while allowing agriculture trade barriers to remain.
  - LDCs formed the G77 (now 134) to advocate for LDC interests, but have not produced a new economic order.

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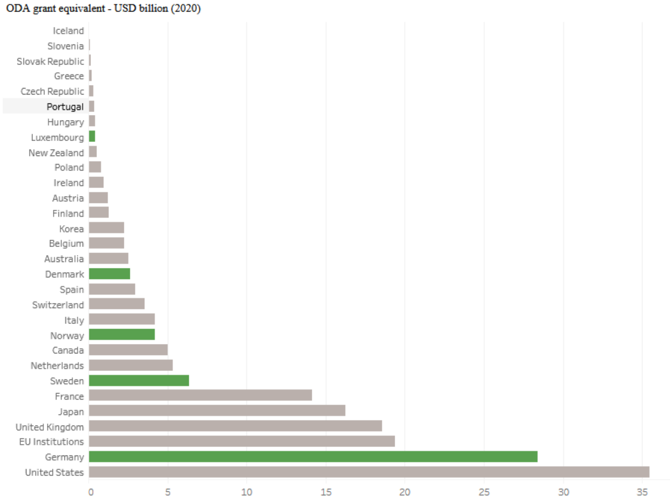
  - About 70% is bilateral from AICs to LDCs
  - Relatively little foreign aid is directed at long-term economic development
- AICs profess a goal of spending 0.7% of GNI on foreign aid, but few do (and there is little political pressure to spend more).

ODA Expenditures 2020



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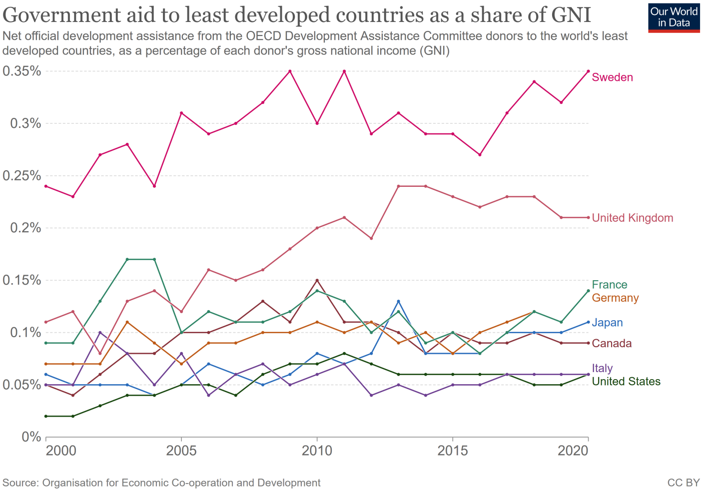

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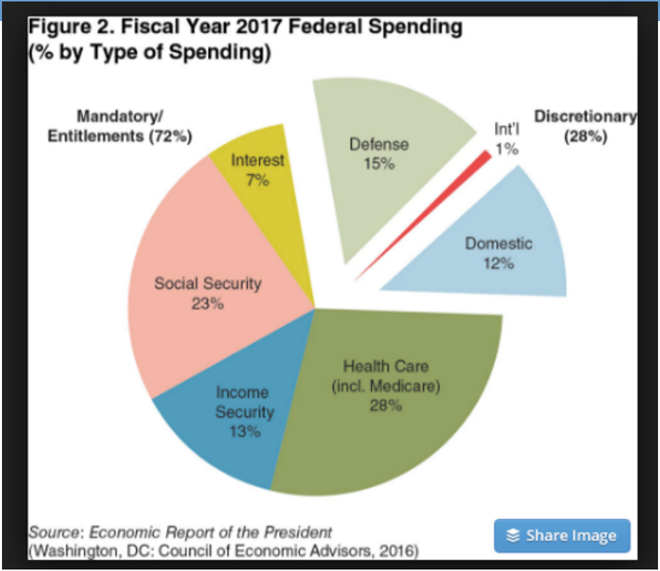
- The reality is that US foreign aid is part of the international affairs budget of the federal government.
- The overall international affairs budget (which includes diplomatic activities as well as aid) is less than 1 percent of total federal spending.

US Foreign Aid FY 2017



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- Some foreign aid is motivated by humanitarian and development goals:
  - UN's Sustainable Development Goals are at the heart of non-strategic aid. These are 17 goals intended to influence donor aid policies through 2030.
- Substantial debate over whether and how aid is effective.

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- Prior research has not found consistent linkages at the country level. However, aid effects may be obscured by selection bias, as aid may be given for political or strategic reasons.
- Recent research that statistically addresses selection effects finds an overall positive effect of US, total OECD-DAC and Chinese aid on growth.

Aid Effectiveness Continued

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- At the subnational level, aid may not be allocated to the poorest areas within target states, but the richest areas (though this does not tell us whether the individuals in those areas are rich or poor) (Briggs 2017).
- Different types of aid may also have different effects, further complicating the picture.

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  - However, AICs are limited by what their domestic politics will accept (e.g. US and agriculture subsidies).
  - ISI failed to help LDCs, and they cannot all gain equally from EOI (though EOI had some successes).

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  - E.g. Doha Round of WTO collapsed in part due to agriculture.
  - E.g. imbalance of power in tax agreements aimed at eliminating double taxation between rich states and LDCs.

Resource Curse Intro

- Development may be complicated even more by a phenomenon called the **Resource Curse**.
- Defining this first requires defining what a "resource" is...

Characteristics of Resources

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- Associated with environmental damage and climate change.

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- The resource curse seems to be particularly common in the developing world.

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- By contrast, resource wealth was also linked with better child health.
  - However, this linkage varies across regions: Middle East (strongest), Latin America, Africa (weakest).

Azerbaijan's Oil Boom

Inflation in Azerbaijan

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  - Less innovation and skill acquisition in non-resource sectors.

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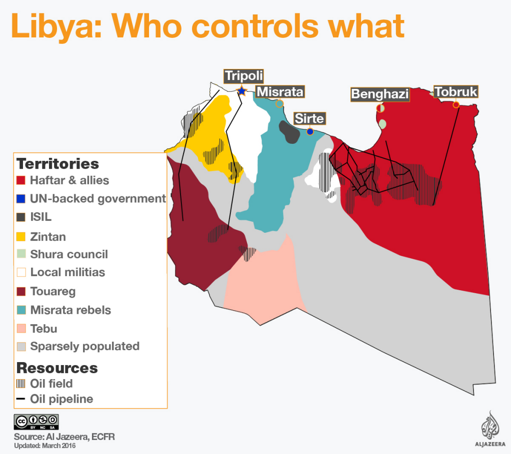
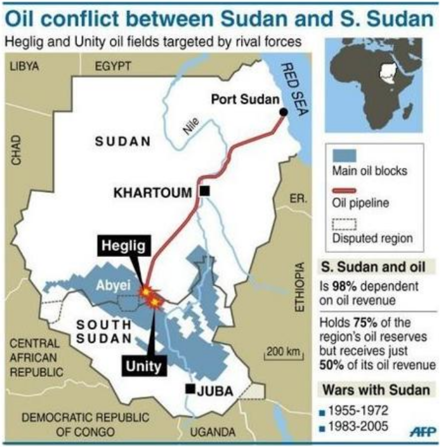
Libya's Civil Conflict 2014-2020



Sudan's Civil Conflict (2013-2020)



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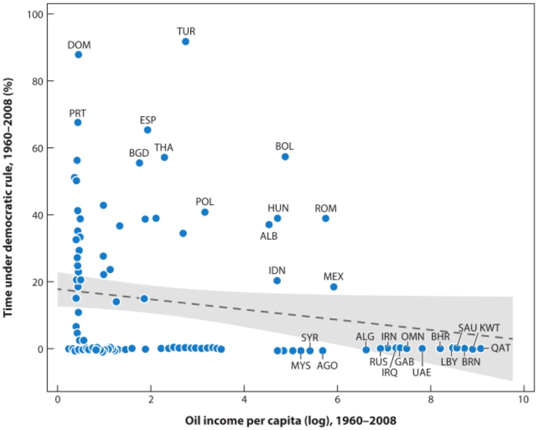
- This could also be the case for other types of "unearned income" (e.g. foreign aid).

Resources and Regime Type



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  - E.g. most non-WTO members are resource-wealthy (Azerbaijan, Iran, Libya, South Sudan)

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  - Thus, rentier states strike a bargain between state and citizens: low taxes and plentiful public sector jobs in return for lessened citizen input into government processes.

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    - Some states trying to focus on improved education without new political accountability (ex: UAE)

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- Substantial negative effects on climate.

Oil Distribution Globally

Crude Oil Reserves in Billion Barrels (Gbbl)

Note: For visualization purposes we are showing only countries with 100,000,000 bbl (0.1 Gbbl) of crude oil reserves or more.

How to read this map: Countries appear bigger as their crude oil reserves are bigger. e.g. Venezuela. Conversely, countries that have smaller reserves of crude oil appear smaller. e.g. Côte d'Ivoire

Article & Sources:
https://howmuch.net/articles/worlds-biggest-crude-oil-reserves-by-country
Central Intelligence Agency - https://www.cia.gov/library

howmuch net

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  - Ensures USD is the most widely-used reserve currency while enabling the US government to easily fund itself.

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- Any instability in a major oil producer becomes threatening to this system, so US may contribute to autocratic stability when trying to keep this system stable.

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- Ross (2015) emphasizes a number of studies which attempt to grapple with this problem.

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  - Canada vs. Democratic Republic of Congo
- Attaining either one of these features *after* discovering resources is incredibly difficult.
  - This is the resource curse in a nutshell: the best solutions are undermined by the very existence of the problem.