



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?



Differences in Development

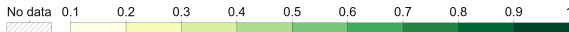
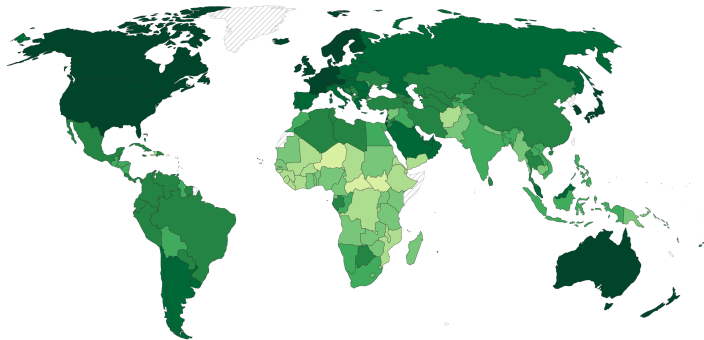
- **Less developed countries (LDCs)** are those states at a relatively low level of economic development.
- As a policy goal, these states want to become more developed.
- While the goal itself is uncontroversial, the steps necessary to develop can cause some conflicts of interest.
- In particular, the 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.



Source: United Nations Development Programme, Human Development Report 2020

OurWorldInData.org/human-development-index/ • CC BY

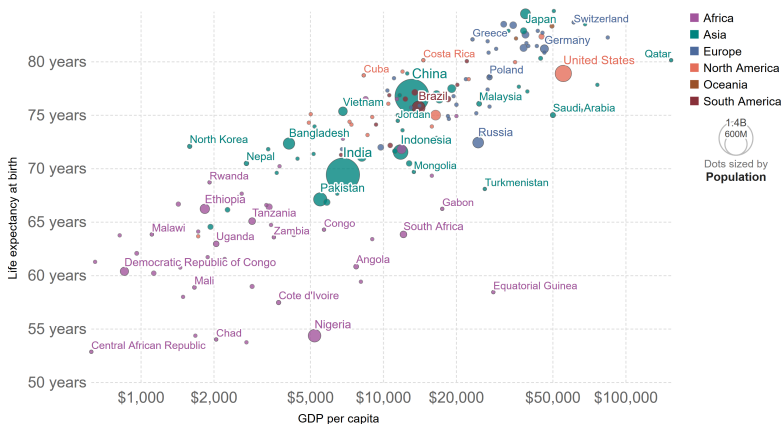


GDPpc and Life Expectancy

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.

Our World
in Data



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

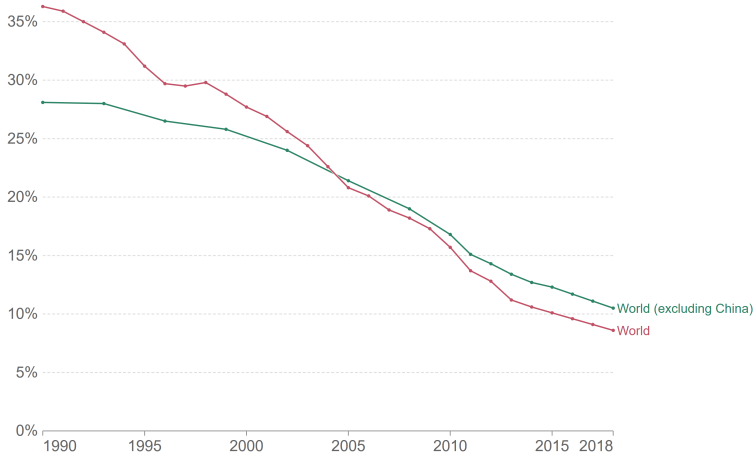


Global Population and Poverty

Share of global population living in extreme poverty, 1990 to 2018

Living in extreme poverty is defined as living below the international poverty line at 1.90 international-\$ per day.

Our World
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Source: World Bank

OurWorldInData.org/extreme-poverty/ • CC BY

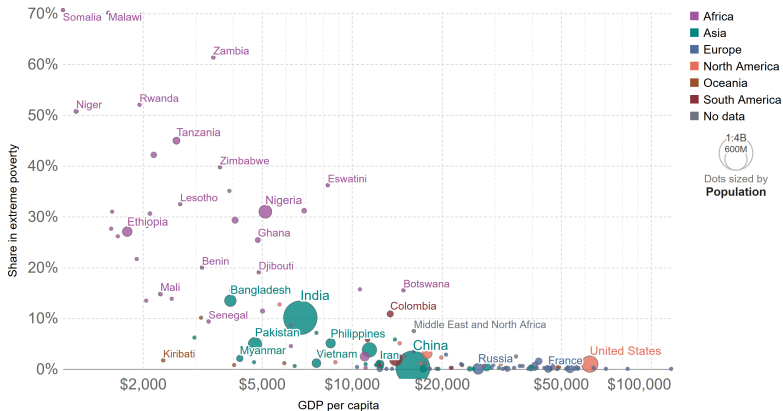


Poverty and GDP_{pc}

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.

Our World
in Data



Source: World Bank PIP; World Bank WDI

OurWorldInData.org/poverty • CC BY

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.



Stages of Development

- The end goal of development efforts is uncontroversial: moving from a lower level of economic development to a higher level of economic development.
- This shift means that the focus of economic activity shifts over time:
 - 1 Subsistence agriculture.
 - 2 Primary sector: production of raw materials and farming.
 - 3 Secondary sector: production of manufactured goods.
 - 4 Tertiary sector: production of services.
- Not the same sectors as in Ricardo-Viner theory!



Stages of Development

- LDCs tend to focus on subsistence, primary sector production, and sometimes secondary sector production.
- 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?



Uncontrollable Aspects: Geography

- Historians have long noticed that tropical regions are generally poor, while temperate regions are generally more wealthy.
- Several potential explanations for this lack of development:
 - Landlocked states
 - Distance from major markets
 - Diseases
 - Weather
- All of these were argued to lead to less development.



Uncontrollable Aspects: Geography

- Problem with this explanation: these geographical limitations were certainly true in the past, but less so in the modern era.
- 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.



Uncontrollable Factors: Colonialism

- Colonialism is often cited as a source for lack of development.
- The counterpoint is that many of the most developed countries in the world were colonies at one point.
- 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.



Contestable Factors: Domestic Politics

- To promote growth, governments must provide:
 - Infrastructure (roads, ports, etc.).
 - Secure property rights.
 - Stable economic policies.



Contestable Factors: Domestic Politics

- Why do governments fail to do some of these things?
 - 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.
 - 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.**



- In the modern era, and especially post-decolonization, the most obvious driver of economic growth was the development policy chosen by many LDCs.
- This policy came in two types: ISI and EOI.



Policy Option: ISI

- **Import-substituting Industrialization (ISI):** create protectionist barriers via high tariffs to close markets to imports, allowing local industry to develop free of foreign competition.
 - Practiced 1950s-1980s.
 - Goal: industrialize via forcing the local production of formerly imported goods, which would eventually be competitive on the global market.
- Required substantial government involvement: trade barriers, government planning, investment policy choices.



Policy Option: ISI

- ISI was practiced from the 1950s-1980s.
- “Easy ISI” produced simple consumer goods.
- Secondary ISI focused on complex goods and machines as well as capital-intensive goods.



Effects of ISI

- ISI produced economic growth in the 1960s and 1970s.
- ISI led to general income redistribution from rural agriculture to urban manufacturing.
- 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

- Risks and failures of ISI led other developing states, especially those in East Asia, to look for a different approach. This led them to...
- **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.



Policy Option: EOI

- EOI produced sustainable growth for East Asian economies (Hong Kong, South Korea, Singapore, Taiwan).
- Trade openness has benefited some developing countries significantly (China, India, Vietnam).
- Eventually became the major recommendation in IMF conditionality.



What are some potential shortcomings of the EOI model?

- Manufacturing competition is intense.
- First mover firms/states do well; later movers lose out.
- State must make accurate and effective long-term decisions regarding which sectors and industries it supports.
- Harder to achieve productivity gains in non-manufacturing sectors, which is problematic in an information economy.

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



Biased Global Economy?

As states have continued their development, some have raised concerns about the modern economy:

- AICs may have firmer control over their market prices, creating biased conditions in the global economy.
 - LDCs: produce primary products with many competitors.
 - AICs: produce specialized manufactured goods.
- Moreover, AICs also protect their primary products, especially farmers, with trade barriers.
 - Ex: in US 2020, farm subsidies were 48% of farm income ([source](#)).
 - This lowers world prices, making it impossible for LDC farmers to compete.



Biased Global Economy?

- LDCs have had no success in convincing rich countries to lower agricultural barriers.
 - IMF voting is a function of economy's size.
 - 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.



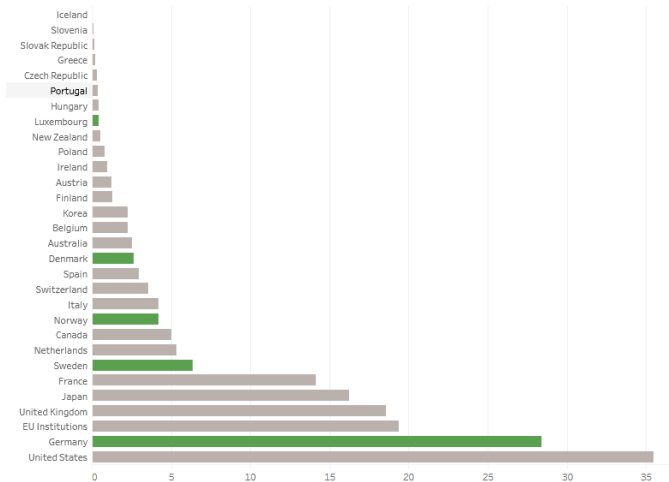
AIC Policy Option: Foreign Aid

- One solution: share the wealth.
- **Official Development Assistance (ODA)/Foreign Aid:** Money or other assistance given to help countries developing economically or to meet basic needs.
 - Covers a variety of programs (political, economic, normative)
 - 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

ODA grant equivalent - USD billion (2020)



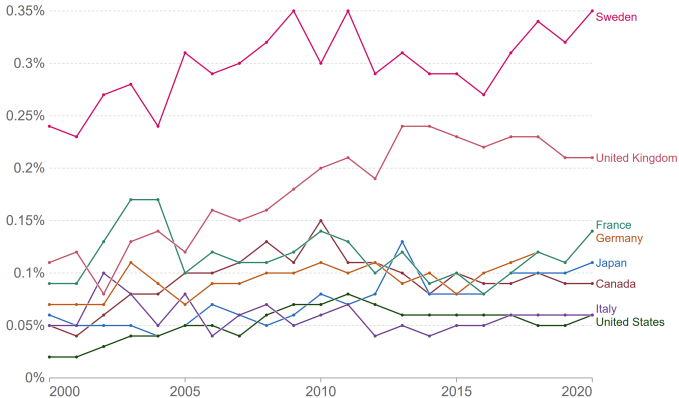


ODA Expenditures 2020

Government aid to least developed countries as a share of GNI

Net official development assistance from the OECD Development Assistance Committee donors to the world's least developed countries, as a percentage of each donor's gross national income (GNI)

Our World
in Data



Source: Organisation for Economic Co-operation and Development

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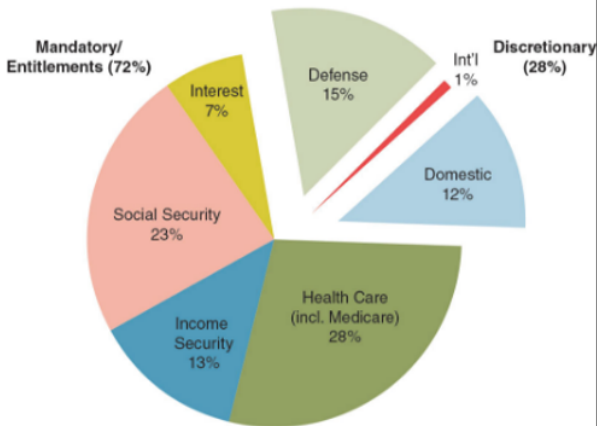
US Foreign Aid vs. US Spending

- When surveyed, Americans report that they believe US foreign aid outflows are up to 20% of government spending.
- 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

**Figure 2. Fiscal Year 2017 Federal Spending
(% by Type of Spending)**



Source: *Economic Report of the President*
(Washington, DC: Council of Economic Advisors, 2016)

[Share Image](#)



How is Aid Spent?

- Aid can be motivated by strategic goals:
 - Alliances and post-conflict countries
 - Potential trade partners (create export markets)
 - Reduce emigration incentives
- 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.



Is aid effective at stimulating development? That is, is there a link between foreign aid and economic growth?

- 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

In addition to selection effects, aid may have unintended consequences...

- Aid may encourage corruption, and it can allow leaders to put off political reforms, as a kind of unearned income/rent.
- 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.



Summary: Conflicting Interests

- Both AICs and LDCs want to spur development globally (for economic, political, and humanitarian reasons).
 - 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).



Summary: Conflicting Interests

- Sharing wealth (i.e. foreign aid) probably has some effect, but is not a cure-all:
 - Easily derailed by strategic/political objectives
 - Potential for resource curse (unearned income)
 - Unclear what exactly is the most effective method
- Thus, the competing visions between AICs and LDCs for what development looks like informs a great deal of economic conflict in IR.
 - 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

- Naturally occurring, extractable resources (not produced).
 - Generally minerals and fossil fuels: oil, diamonds, gold, cobalt, etc.
 - Esp. materials used for fuel (including renewable energy).
- Minimal labor required to extract them (compared to agriculture and manufacturing).
 - Can be *technologically* easy (alluvial diamonds) or difficult (oil).
- Finite supply.
- Valuable as inputs into other processes.
- Highly portable, thus easily exported.



Why Are These Resources Problematic?

- Potential independent influence on political institutions.
- Unlikely to enhance economic productivity in the long-term.
 - Low labor requirements, tech transfer unlikely, low incentives to increase productivity
- High value may inflate the currency and cost of business for other industries.
- Use as inputs means they're not necessarily directly useful to the economy.
- Associated with environmental damage and climate change.



Resource Curse Types

- Natural resources are empirically associated with three potential “curses,” creating **the resource curse**:
- **Economic:**
 - Poor economic growth
 - Poor long-term economic outcomes
- **Political:**
 - Greater likelihood for civil conflict
 - Worse governance and institutions
- **Social:**
 - Worse demographic and equality outcomes
- The resource curse seems to be particularly common in the developing world.



Resources and the Economy

- Is resource wealth correlated with lower rates of economic growth?
 - Answers depend on the time frame of the analysis.
- Resource endowments are linked with greater growth **volatility**.
 - 1974-1989: the more oil countries produced, the greater their economic decline.
 - Resources often also linked with rising inequality.
- By contrast, resource wealth was also linked with better child health.
 - However, this linkage varies across regions: Middle East (strongest), Latin America, Africa (weakest).

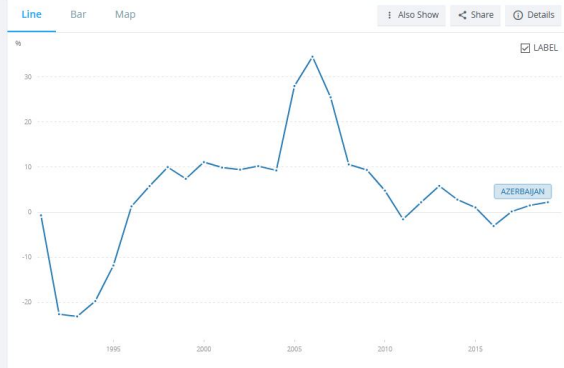


Azerbaijan's Oil Boom

GDP growth (annual %) - Azerbaijan

World Bank national accounts data, and OECD National Accounts data files.

License: CC BY-4.0





Inflation in Azerbaijan

Inflation, consumer prices (annual %) - Azerbaijan

International Monetary Fund, International Financial Statistics and data files.

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Resource Endowments and Growth

- Ross (2015): resource-rich countries haven't grown any faster than any other countries. Why not?
- One explanation is “**Dutch disease**”: positive wealth shocks from the resource sector put upward pressure on prices throughout the economy.
- As labor and other input costs go up in the non-resource sectors, those firms become globally noncompetitive.
- Wages in the resource sector deter workers and entrepreneurs from participation in other sectors, further weakening them.
 - Less innovation and skill acquisition in non-resource sectors.

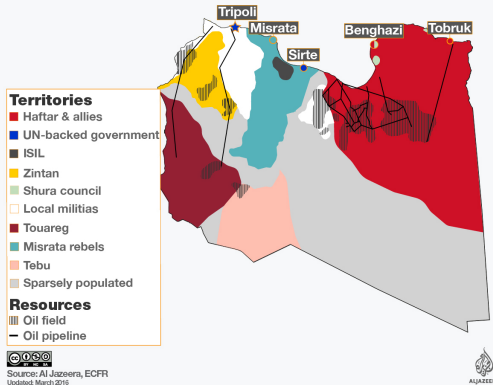


- Positive and significant relationship between resources and the occurrence of civil war.
 - Effect present for both oil *and* other natural resources.
 - Inverted U-shape relationship: at very high or low levels of resource wealth, probability of conflict lessens.
 - Example: Libyan civil war.
- Location of resource also matters:
 - Offshore vs. onshore oil wells.
 - More conflict in poor areas, and in areas dominated by ethnic minority.
- **No scholarly consensus on causal mechanisms behind this relationship, but it does exist.**



Libya's Civil Conflict 2014-2020

Libya: Who controls what

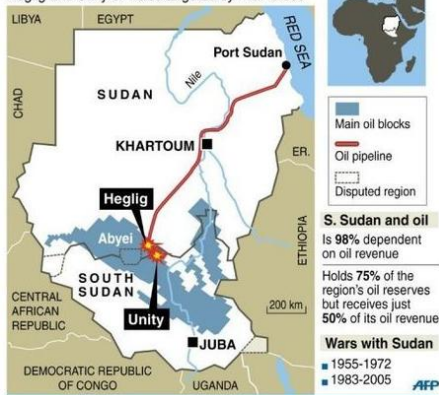




Sudan's Civil Conflict (2013-2020)

Oil conflict between Sudan and S. Sudan

Heglig and Unity oil fields targeted by rival forces



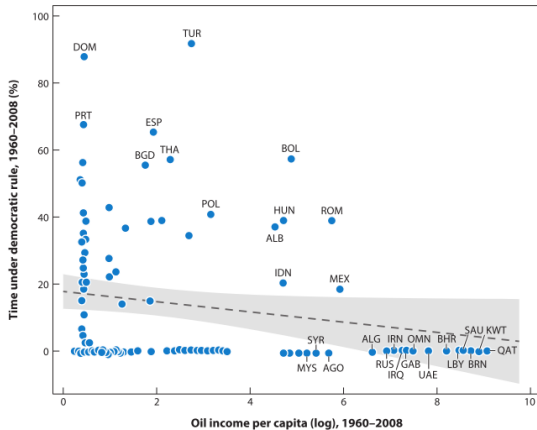


Resources and Domestic Institutions

- Higher levels of **oil** wealth help authoritarian regimes and rulers ward off democratic pressures.
 - Effect holds under certain conditions, such as nationalized oil industries.
 - Total level of resource wealth is more important than changes in it.
- The effect of resource wealth in democracies is less clear.
 - But it appears to bolster incumbents, meaning less leader turnover.
- How does this actually work?
 - **Unearned income** means fewer pressures for accountability if not dependent on taxation to fund government activities.
- This could also be the case for other types of “unearned income” (e.g. foreign aid).



Resources and Regime Type





Resources and Society

- There is a significant link between low levels of gender equality in politics and broader society, and resource wealth.
 - There also appears to be a link to low levels of income equality overall.
- Some resources appear to be linked to slave and child labor.
- Resource wealth (particularly oil) generally connected with higher levels of corruption and lower bureaucratic efficacy.
- Oil-rich countries are also less likely to be cooperative internationally.
 - E.g. most non-WTO members are resource-wealthy (Azerbaijan, Iran, Libya, South Sudan)



- The Middle East is known for its concentration of oil wealth.
 - Revenue generated by oil exporters (Saudi Arabia, UAE, Iran)
 - Remittances (from employment in oil-rich economies) to the neighboring countries (Lebanon, Jordan, Egypt)
 - Most states possess oversized public sectors and function as **rentier states** that get a substantial portion of revenue from resource profits rather than taxation, and tend to be autocratic.
 - 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.



- The problem with the rentier state system is that it requires that profits continue to flow in, while the population remains at a stable level.
- As revenues decline and populations grow...
 - Fiscal pressure on governments increases
 - Some reforms in 2000s, but without accompanying political change
 - Some states trying to focus on improved education without new political accountability (ex: UAE)



Why is Oil Special?

Much discussion of both resources and the resource curse is framed around oil. Why?

- Widely distributed globally: variation both geographically and politically.
- Energy input for manufacturing and transportation.
 - Necessary component of international trade and globalization.
- Strategic military asset.
- Relatively historically recent, thus vast untapped reserves.
- Technologically difficult to extract and to refine.
- 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



The Petrodollar System

- Oil is also special because the USD is tied to oil.
- Bapat (2019) compares the **petrodollar system** to the gold standard and Bretton Woods.
 - US convinces Saudi Arabia to sell oil exclusively in USD...
 - ...in exchange for respecting regime and territory (e.g. First Gulf War)
 - Saudi Arabia re-invests those USD in US bonds.
 - Ensures USD is the most widely-used reserve currency while enabling the US government to easily fund itself.



The Petrodollar System

- Bapat argues 9/11 gave US pretext to invade Iraq to prevent destabilization of petrodollar system, as Saddam was threatening to sell in Euros.
 - Also informs US interpretation of Iran and Venezuela as existential threats despite the military power disparity.
 - US projects force globally to protect major oil-transport waterways.
- 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.



Endogeneity and the Resource Curse

- Recall the concept of endogeneity: the resource curse may be observed because we are missing some other important factor.
- Endogeneity can be due to common cause, reverse causation, or spurious association.
 - Weak political institutions or poor economic growth are not random.
 - Institutions and the economy may be the **cause** of the curse, not the result.
- Ross (2015) emphasizes a number of studies which attempt to grapple with this problem.



Is the Curse Real?

- Economically: strong theories and associations for the resource curse.
- Politically:
 - Civil conflict association is real, but no theory to explain.
 - May be conditional upon pre-existing domestic institutions:
 - Makes autocracies more autocratic and less accountable.
 - Less clear effect on democracies, but may undermine weak democracies.
- Oil appears to be a special case, due to its unique characteristics:
 - The major input into world production and trade
 - US influence through petrodollar system



- Best case: have transparent, accountable, domestic political institutions in place to manage resource extraction before it starts.
 - Botswana has **successfully managed** its resource wealth
- Have an already-diversified economy when resources are discovered.
 - Abundance is not the problem; *dependence is*
 - 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.