
What Can We Learn about the “Resource Curse” from Foreign Aid?

Kevin M. Morrison

A large body of literature has arisen in economics and political science analyzing the apparent “resource curse”—the tendency of countries with high levels of natural resources to exhibit worse economic and political outcomes. The author examines the purported causal mechanisms underlying this “curse” and shows that they all center on the revenue that these resources generate for the government. As such, it is not surprising that the most recent literature on the topic has demonstrated that, in the hands of a competent government, natural resources have no negative consequences and may actually have positive effects. The important question therefore is: What can be done in countries without effective governments? Policy proposals have centered on (a) taking the resources out of the hands of the government or (b) having the government commit to use the funds in certain ways. Neither of these has been particularly successful, which we might have predicted from research on another important nontax revenue source for developing countries: foreign aid. The close parallels between the foreign aid and “resource curse” literatures are reviewed, as are the lessons from the aid literature. These lessons suggest the need for an important change in approach toward poorly governed resource-rich countries. JEL codes: F35, F50, H27, O19, Q3

What approach should high-income countries adopt toward low-income countries rich in natural resources like oil, if they want the resources to be used for development? As commodity prices have boomed over recent years, billions of dollars have been generated for developing countries. Yet instead of being welcomed, this extra revenue has been greeted by most observers with a great deal of trepidation. While there has been some hope that this windfall will have a beneficial development impact, an influential body of research has argued that countries rich in natural resources do worse economically and politically than they otherwise should, so

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there has been far more emphasis in the international community on how countries need to avoid the “curse” that apparently comes along with natural resources (for example [Overseas Development Institute 2006](#); [Naím 2009](#)). Is there anything rich countries can do to counteract these apparently negative effects, particularly as commodity prices will likely remain at historically high levels ([World Bank 2009](#))?

I will attempt to answer this question by examining the experience with foreign aid. While the comparison between foreign aid and natural resources may initially seem strange, I argue in this paper that the relevant differences between natural resource revenue and foreign aid are in fact few. As I will detail, the problems linking natural resource wealth to poor political and economic outcomes derive from how the revenue from these resources is used. As such, in many cases there should be no particular difference between a country getting its revenue from aid or, for example, oil. Not surprisingly, as reviewed below, the literature analyzing the effects of aid describes very similar effects as those in the “resource curse” literature, though this body of work tends to get much less attention.

The similarities between these two revenue sources have important policy consequences. Though they act in similar ways, policy prescriptions for natural resources and foreign aid have diverged sharply in recent years. While foreign aid donors have been moving in a direction that emphasizes partnership with recipient country governments, policy prescriptions regarding natural resources have focused on taking the resources out of the hands of governments. The reasons for these two directions are reviewed below, and I show that foreign aid policy used to look very much like natural resource policy looks now. The poor experience with aid effectiveness historically suggests that current policy regarding natural resources is unlikely to be successful—a suggestion which the recent record supports.

The next section reviews the literature linking natural resources to poor economic and political outcomes, detailing how the major problems are caused by the revenue these resources generate. I will also discuss the policy recommendations made to deal with these problems and their lack of success. In the following section, I review how the aid community for decades experimented with various mechanisms to improve the effectiveness of aid in poorly governed countries—many mechanisms quite similar to those recommended now for natural resources—and found their success limited. As a result, the aid community has in recent years changed its approach. In the next section, I discuss how this new approach might be applied in the case of natural resources—a very different tactic than is being implemented now.

The Revenue Curse

According to an influential literature, the presence of natural resources has negative economic and political consequences, such as worse economic growth

(for example [Sachs and Warner 1995](#)) and more authoritarian political regimes (for example [Ross 2001](#)). This section examines the causal mechanisms linking the resources to these effects: “Dutch Disease”, revenue volatility, and a broad area I refer to as “political deterioration.” Most importantly, I will demonstrate that each of these underlying causal mechanisms connecting natural resources and these outcomes can be linked to (a) natural resource revenue and (b) how governments use that revenue. This indicates that we may be able to learn about how to manage this revenue from what we know about how to manage other kinds of nontax revenue.

One of the most well known effects of the discovery of natural resources is the appreciation of the real exchange rate, leading to what is often referred to as “Dutch Disease.” The appreciation of the exchange rate is caused by the rise in the value of natural resource exports, and it generally makes other (non-natural resource) commodity exports less competitive. With imports now cheaper, it also becomes more difficult for domestic producers to compete in the local market. In addition, as local labor and assets are used by the natural resource sector, their prices increase, making them more expensive for producers in other sectors. The overall result is a privileging of the natural resource and nontradeable sectors, crowding out the traditional exports in an economy (manufacturing, agriculture, or both).

However, Dutch Disease does not *necessarily* occur when natural resources are discovered—whether it does depends to a great extent on how the government spends the resulting revenue. As Sachs ([Sachs 2007](#), p. 184) has argued: “The real fear of the Dutch Disease, in short, is that the non-oil export sector will be squeezed, thereby squeezing a major source of technological progress in the economy. *But this fear is vastly overblown if the oil proceeds are being properly invested as part of a national development strategy.* If the proceeds from oil are used not for consumption but for public investment, the negative consequences of real exchange rate appreciation can be outweighed.” In other words, a competent government should be able to avoid this aspect of the “resource curse” (also see [van Wijnbergen 1984](#)).

Indonesia’s experience with its oil boom in the late 1970s demonstrates how this might occur in practice. Instead of spending its increased revenue on current spending (as Mexico did for example, by mainly promoting its state oil company), the Indonesian government spent the oil revenues on agriculture and industry, the tradeable sectors, in order to strengthen production. As [Usui \(1997\)](#) notes, perhaps the most striking aspect of Indonesian policy was its emphasis on agriculture. The Indonesian government used the oil revenues to encourage a boom in rice production, promoting research and extension, investment in irrigation, and subsidizing fertilizer use. The government’s procurement agency kept the producer price of rice high and subsidized the use of fertilizer in order to take

advantage of new Green Revolution crops. As a result of these incentives to farmers, Indonesia was self-sufficient in rice production by the mid-1980s (Booth 1988).

Malaysia provides a similarly successful example of avoiding Dutch Disease. Revenues from crude petroleum discovered in the mid-1970s, and subsequently from liquefied natural gas, were invested as opposed to consumed. This policy built on Malaysia's attempt to diversify its economy away from dependence on rubber and tin. As in Indonesia, much of this strategy revolved around modernizing the agricultural sector, as the government developed programs to launch new commercial crops (like palm oil) and improve the performance of already existing crops (such as rubber). These actions were part of an overall focus on investing resource proceeds into economic and social infrastructure—half of public investment went into energy, communications, and transport, while 10–17 percent went into education, housing, and health (Abidin 2001).

In addition to Dutch Disease, natural resource exporters also face a problem of volatility in revenue. As Humphreys, Sachs, and Stiglitz (2007b) have discussed, this volatility has several sources, including resource extraction rates that vary over time, governments' back-loaded contracts with producing companies, world price fluctuations, and procyclical lending that tends to accentuate booms and busts. The volatility creates a problem for fiscal policy: because there are diminishing marginal benefits to public spending, the social gain from spending more in some years does not make up for the social cost of spending less in others.

However, like Dutch Disease, this is a problem that can be overcome with a competent government in place—one that can “smooth” spending over a period of time. There are a variety of ways that this can be accomplished, though the most popular option recently has been to set up “natural resource funds,” which (when they function well) store revenues when natural resources are booming and then augment public spending when revenues diminish.¹ For example, Chile established a Copper Stabilization Fund (CSF) in 1985 with the purpose of stabilizing the exchange rate and fiscal revenues in the context of rapidly changing copper revenues. A savings rule was determined that transferred resources into the fund at a rate based on the difference between copper's actual price and the government's estimated long-term copper price. The higher the actual price was in comparison to the long-run price, the more resources were transferred (and vice versa, if the price differential were negative). The fund has generally accomplished its purpose, and budget expenditures have not closely followed revenue variability, as was the case prior to the CSF (Fasano 2000).

The final causal mechanism (or set of mechanisms) linking natural resources to a “curse” can broadly be called “political deterioration.” Natural resource rents have been linked to greater corruption and weaker accountability (Leite and Weidmann 2002) and less democratization (Ross 2001). Accountability

arguments tend to center on the ability of governments with these revenues to avoid taxing their citizens, which is often thought to have played a key role in the development of Western representative institutions (Tilly 1990; Ross 2004). Many explanations for the link between natural resources and less democratization have similarly focused on revenue (Anderson 1995; Karl 1997), as these resources simply give political regimes more money with which to pursue their various strategies for staying in power. As Jensen and Wantchekon (2004, p. 821) state: “The key mechanism linking authoritarian rule and resource dependence, both in democratic transition and democratic consolidation, is an incumbent’s discretion over the distribution of natural resource rents.”

As with the first two “resource curse” mechanisms, however, the fact that these political mechanisms revolve around the use of revenue indicates that the effects are likely due to the institutions in place when these revenues arise. For example, building on this logic, I (Morrison 2009) have argued that these revenues are not “anti-democratic” or even “pro-democratic”, but simply stabilizing, in the sense that they solidify whatever political regime they enter. I used panel data from 104 countries over the period 1973–2001 to show (using ordinary least-squares analysis [OLS]) that nontax revenue—generated, for example, by state-owned natural resource companies—is associated with lesser probability of a regime transition in both democracies and dictatorships (measured in a variety of ways).

One good example of this dynamic is Botswana, a country that has *benefited* from its natural resources economically and politically. Botswana’s growth rate has been among the highest in the world over the past 40 years, and it has had freely contested democratic elections since independence. In their analysis of Botswana’s success, Acemoglu, Johnson, and Robinson (2003, p. 105-6) note the critical importance of the existing institutions when diamonds appeared on the scene: “By the time the diamonds came on stream, the country had already started to build a relatively democratic polity and efficient institutions. The surge of wealth likely reinforced this. Because of the breadth of the BDP [Botswana Democratic Party] coalition, diamond rents were widely distributed, and the extent of this wealth increased the opportunity cost of undermining the good institutional path.”² By contrast—though through a similar dynamic—when oil prices surged in the 1970s and massive rents accrued to Mexico’s authoritarian party, it stabilized that party against strong democratization forces (Magaloni 2006).

In sum, the various negative effects that have been attributed to natural resources are caused by the revenue that these resources generate and how governments use that revenue. For this reason, it is not surprising that the most recent and important theoretical work on the “resource curse” is highlighting the fact that these resources have very different effects depending on the institutional

environment in place in a given country (Hodler 2006; Mehlum, Moene, and Torvik 2006; Robinson, Torvik, and Verdier 2006; Bhattacharyya and Hodler 2009). In beneficial institutional environments, natural resources have no negative effect and can even have positive economic impacts, while in poor institutional environments these resources have negative effects. Similarly, on the political side, most recent theoretical work has focused on how these resources can stabilize democratic regimes, and not just authoritarian ones (Dunning 2008; Smith 2008; Morrison 2009).

This theoretical turn has been supported by several recent empirical works. Using panel data from 124 countries over the period 1980–2004, and several different measures for natural resources, democracy, and corruption, Bhattacharyya and Hodler (2009) find (using OLS and two-stage least-squares [2SLS] estimation with instrumental variables) that resource rents lead to an increase in corruption if the quality of the democratic institutions is relatively poor, but not otherwise. Using panel data from 80 countries over the period 1975–98, Boschini, Pettersson, and Roine (2007) use four different measures of natural resources to show (using OLS and 2SLS) that appropriable natural resources have a negative effect on growth in low-quality institutional environments and a positive effect in high-quality institutional environments. They use seven different measures of institutional quality, including indicators of the rule of law, the protection of property rights, the risk of expropriation, and the risk of repudiation of contracts by the government (Kaufman, Kraay, and Zoido-Lobaton 2002; Keefer and Knack 2002).

Similar results have been found by others. Using the original data of Sachs and Warner (1995), consisting of 87 countries, Mehlum, Moene, and Torvik (2006) show (using OLS) that natural resources only reduced per capita income growth over the period 1965–90 in countries with poor institutions, but not those with good ones (measured using indices in Keefer and Knack 2002). And Hodler (2006) uses a measure of natural resources per capita and various measures of ethnolinguistic and religious fractionalization to show (using OLS and 2SLS) that natural resources increase per capita income in homogeneous countries but reduce it in very fractionalized ones.

While these theoretical advances and empirical results are encouraging, in that they dispel the notion that natural resources must be associated with a curse, they also raise a troubling problem: What can be done with these resources when they accrue to countries with poor institutional environments? Several options have been suggested. Given that the major problem is how governments use natural resource revenues, one of the central thrusts of policy recommendations has been to lessen government control over how these revenues are used. This can be done in one of two ways. The first is to take the resources away from the government or otherwise bypass the government in some way, including proposals

to privatize state-owned oil companies (Weinthal and Luong 2006) or distribute oil wealth directly to citizens (Birdsall and Subramanian 2004). The second way is to keep the resources in the hands of the government but attempt to change the government's actions somehow. This has included putting the money in natural resource funds (Varangis, Akiyama, and Mitchell 1995) that include some sort of conditions over the way the funds are used, overseen, or both.

As discussed in greater detail below, where they have been implemented, these policies have not been particularly successful. For example, countries where natural resource funds seem to have worked properly are countries that were managing their fiscal situation well to begin with (Davis and others 2001; Pegg 2006; Independent Evaluation Group 2009). While disappointing, the lack of effectiveness of these mechanisms should not be surprising. The countries discussed above—examples that avoided the “resource curse”—were successful in managing their resources not because they put in place some particular mechanism to insulate themselves. Rather these were countries whose growth trajectories indicate they were doing many things right—managing their natural resources well was just part of their overall economic competence. In addition, while the mechanisms suggested by the policy community with regard to natural resources may be seen as innovative in that community, their lack of success would not seem strange to those who focus on another major revenue source for developing countries: foreign aid. The reasons why, and the implications of the experience with foreign aid, are explored in the next section.

The Lessons of Foreign Aid

In addition to highlighting the importance of the institutional environment for determining the effect of natural resources, the fact that the “curse” of these resources is caused by revenue raises an important question: Why is natural resource revenue different from other kinds of revenue, particularly others that are not generated through taxation? Though one of the first influential analyses of states dependent on oil mentioned similarities between oil rents and other types of externally obtained revenues (Beblawi 1987), it is only recently that scholars have begun to explore these similarities in more depth.

The principal external revenue with which natural resource revenue has been compared is foreign aid (Bräutigam 2000; Svensson 2000; Moore 2001; Therkildsen 2002; Collier 2006; Morrison 2007; Smith 2008). As Collier (2006, p. 1483) notes, “both are ‘sovereign rents.’” And in fact, it is striking to note how similar the literatures on the effects of aid and natural resources are. Scholars have linked aid to poor economic and political outcomes because of exactly the three causal mechanisms discussed above: Dutch Disease (for example Younger 1992;

Adam and Bevan 2003; Rajan and Subramanian 2005), aid volatility (Bulir and Lane 2002; Arellano and others 2009), and political deterioration (for example Knack 2001; van de Walle 2001; Bräutigam and Knack 2004). And as the severity of these mechanisms depends on the institutions in place in a country, many scholars have argued that aid's effect is contingent on the institutional environment in place, just as with recent research on natural resources (for example Isham, Kaufmann, and Pritchett 1997; Burnside and Dollar 2000, 2004; Kosack 2003; Mosley, Hudson, and Verschoor 2004; Gomanee and others 2005; Kosack and Tobin 2006; Wright 2008; Baliaoune-Lutz and Mavrotas 2009; Morrison 2009).³

However, despite these apparent similarities, policy recommendations regarding these two revenue sources have moved in almost opposite directions in recent years. As discussed above, the general thrust of the natural resource literature has been to take the money out of the hands of the government, or at least attempt to change the way the government uses it. In the aid community, by contrast, the movement has been toward ensuring governments have “ownership” over the way they spend the resources. If donors are concerned about development outcomes, this approach has implied giving aid to those countries that already have good institutions and policies in place, as opposed to trying to change the behavior of governments.⁴

Why has the foreign aid community moved in this direction? The answer is that for decades donors tried tactics very similar to those that are now being recommended for natural resources—attempting to change governments' behavior or bypass them to some degree—and found them to be largely unsuccessful. As such, it is worthwhile to review the literature that has studied these tactics. Donors' efforts in this regard took one of two forms, policy conditionality (attempts to change governments' behavior) or projects (attempts to bypass the government to some degree). This section looks at these efforts in turn.

Policy conditionality—attempting to change a government's policies in exchange for money—has been one of the more controversial aspects of foreign aid practice over the past few decades. Underlying the ideas of both the practitioners of it (most donors) and its critics (many non-governmental organizations) has been the assumption that these conditionalities actually work—that is, the assumption that governments actually implement the policies required by foreign donors. In fact, while there are certain instances in which these conditions have probably influenced a government to act in a specific way, studies have largely concluded that these conditions have no systematic influence on policy (World Bank 1992b; Mosley, Harrigan, and Toye 1995; Collier 1997; Alesina and Dollar 2000; Burnside and Dollar 2000; van de Walle 2001; Easterly 2005; Heckelman and Knack 2008).⁵

There are two principal reasons why conditionality has not worked in general. The first is on the recipient side—simply put, there are strong political forces in

place opposed to the policy conditions. If this were not true, conditionalities would of course usually be unnecessary: the policy would already be in place. Opposition may be in the executive branch or outside it, but either way it is likely to continue even if the policy is instituted at first. As such, policies adopted because of conditionalities are often reversed or simply ignored in practice. This raises the second reason conditionality has not worked, this one on the donor side: donors have strong incentives to continue to disburse funds even if conditionalities are not met. These incentives can be political, such as the need to support a government for strategic reasons; or they can be economic, such as the need not to disrupt strong trade or investment relationships with the country. The incentives can even be bureaucratic, such as the need for aid agencies to disburse all their funds in order to get the same amount of funds the following year. Regardless of their origin, these incentives often mean that aid is disbursed regardless of whether or not conditions are met ([World Bank 1992b](#)).

The other donor approach to making aid more effective—implementing projects—has similarly led to disappointing results. Projects do not bypass the country's government to the extent that, for example, privatizing state-owned oil companies would—many are designed in cooperation between donors and governments. However, there is little doubt that project-based aid is meant to reduce the discretion of recipient countries in terms of how to spend the money. Principal-agent theory suggests, for example, that as preferences between a donor (the principal) and the recipient country (the agent) increasingly differ, the donor should augment its control of how the money is spent ([Winters 2010](#)). Policy prescriptions in this regard are not difficult to find: [Radelet \(2004, p. 13\)](#) writes, for example, that “in weak, failing, and poorly governed countries, donors should retain a strong role in setting priorities and designing programs.”

Nevertheless, three problems have undermined donor-financed projects. First, aid that goes to finance projects is largely fungible, in the sense that it simply enables a government to take money it would have spent on that item (for example, a school) and spend it on another item ([Feyzioglu, Swaroop, and Zhu 1998](#)). In this way, while donors may fund a school, their money may simply free the government to spend its money on other priorities (arms, for example). Second, taking the money out of the hands of the government hinders the building of a capable state, a necessity for development if historical experience is any guide. Proliferation of projects funded by dozens of different donors has made it extremely difficult for governments to monitor what is going on in any given sector, and the high transaction costs tend to undermine bureaucratic quality ([Knack and Rahman 2007](#)).

Third, and perhaps most important for comparison to natural resource revenues, there is now a fair amount of evidence regarding the inability of projects to succeed in the context of a poor policy environment ([World Bank 1992a](#); [Easterly](#)

2002). The reason is fairly intuitive. If a donor builds a road, for example, in a country where there is no funding for maintenance from the government, or where the economic policies do not encourage new investment and entrepreneurship, the road is likely to be ineffective in spurring economic development.

What are the overall implications for natural resources of the aid literature on conditionality and projects? Essentially the aid literature provides a framework by which to understand better the disappointing results—and pessimistic prospects—for the various policy proposals put forward for avoiding the “resource curse.” For example, consider the proposals to take natural resources out of the hands of the government. Privatization of the resources—one of the ways to do this—has experienced the same type of problems that have plagued project-based aid. In the absence of a good institutional environment—such as a developed legal system, a tax administration to collect revenues, and a corporate governance regulatory structure—privatizing the resources has led to a few people getting very rich and countries as a whole seeing little benefit (Stiglitz 2007). While some may argue that in the longer term the newly rich will begin to demand better institutions, there is no particular historical or theoretical reason to expect this (Hoff and Stiglitz 2005).

Transferring natural resource revenues in lump-sum form to citizens—another way of taking the resources out of the hands of the government—is similarly unlikely to succeed. As Sachs (2007) argues, what poor countries need to develop are infrastructure and primary health and education, services that must be provided by the government. Transferring resources to citizens in the absence of good governance is unlikely to result in any wide-scale development of the country, as such development requires a functioning government.

While much of the discussion here has focused on the economic impacts of these mechanisms for dealing with natural resources, there are also reasons to doubt their ability to improve the political situation in a country. For example, one might expect that taking money out of the hands of an authoritarian regime—by distributing the money to citizens, for example—would help to destabilize the regime. However, I (Morrison 2007) have shown that even if one assumes that the arrangement works perfectly (for example there is no corruption), under a broad set of conditions this type of arrangement will not destabilize the dictatorship. I used the game theoretic framework advanced by Acemoglu and Robinson (2006), analyzing how redistributive conflicts between rich elites and citizens affect political regime transitions (also see, for example, Rueschemeyer, Stephens, and Stephens 1992; Boix 2003), and I demonstrated that distributing money to citizens essentially defuses demands for regime change from lower- and middle-income citizens who would benefit under a democracy.

The foreign aid literature also indicates that the other set of policy mechanisms—aiming to change the way governments use natural resource rents—is also unlikely

to be successful. The general conclusion has been that in the absence of “ownership” on the part of the government—that is, without the government supporting the policies of its own accord—any policies put in place on the basis of “conditions” are likely to be reversed. Even if one sets up a natural resource fund to finance social spending, for example, the implication is that eventually this fund will be raided by the government for other purposes (Humphreys and Sandbu 2007).

Perhaps the best example of these problems in the case of natural resources has been the largest attempt to shield natural resource revenues from bad governance: the Chad–Cameroon pipeline project overseen by the World Bank starting in 2000. Despite the Bank’s “unprecedented system of safeguards assuring that the revenues are used to reduce poverty,” there were major problems of noncompliance with the Bank’s various desires (Pegg 2006; Gould and Winters Forthcoming).⁶ Chad’s President Idriss Déby spent \$4.5 million of his country’s \$25 million “signing bonus” on his military. The IMF (2003) found that the government was not allocating sufficient funds to health, education, and other priority sectors. And the group that monitors Chad’s compliance with environmental and social safeguards found that the government was not following the country’s own stated poverty reduction strategy (International Advisory Group 2004). In 2005, Déby amended his country’s revenue law to spend more on the military, in direct violation of Bank conditions. While the Bank protested initially, it eventually capitulated.⁷ In March 2008, Déby used a state of emergency decree to suspend Chad’s compliance with the remaining Bank conditions with regard to poverty spending. Finally, in September 2008, the Bank decided to cancel the project.

In other words, the most elaborate measures designed to date to change the way a government uses its natural resources were unsuccessful. A recent evaluation of the project by the Independent Evaluation Group of the World Bank concluded that the project’s fundamental objective of reducing poverty and improving governance was not achieved. Just as significantly, the review concluded that “no alternative program design or closer supervision would have allowed to achieve [*sic*] the program’s development objectives in the absence of government commitment” (Independent Evaluation Group 2009, p. viii).⁸

Do these lessons and experiences mean that aid and natural resources can never have developmental effects? Certainly not—in fact, that is exactly the message from the literature reviewed above studying the conditional effects of these revenues in different institutional environments. And largely on account of that research, many donors have begun to change their relationships with recipients in two important ways in order to ensure that aid is more effective.

The first might be seen as an attempt to change the institutional environment itself. The World Bank and the International Monetary Fund (IMF) now require “Poverty Reduction Strategy Papers”, documents outlining the government’s

poverty reduction policies that are drawn up in consultation with non-governmental organizations (NGOs), the private sector, and other important actors in society. This venturing into areas of governance has been criticized by some observers (for example [Srinivasan 2001](#)), who argue that these organizations have no expertise or remit to involve themselves in a country's politics in this way. However, the Bank and the IMF hope that this deliberative approach will lead to more sustainable, country-owned policies that donors can support ([World Bank 2002](#), p. 240). It is unclear whether this will be more successful than previous forms of conditionality. There are some social science theories that indicate building societal consensus may be possible under certain conditions, but these conditions are extremely rigorous, such as complete equality among participants in the deliberation ([Morrison and Singer 2007](#)).

The second way that donors have changed their aid delivery is to limit to whom they give it. Following the implications of the research reviewed above, some donors have begun to implement a principle of “selectivity,” by which they mean that recipient countries should receive more aid if they already have good policies in place. This idea took particular hold of the donor community after work by Craig Burnside and David Dollar at the World Bank showed that aid was more effective in certain policy environments ([World Bank 1998](#); [Burnside and Dollar 2000](#)). This work has generated a large response, with some scholars confirming their results and others arguing that their results are not robust (a good review is provided by [Easterly 2003](#)). However, as one of the critics of their empirical analysis, William Easterly (2007, p. 645), writes, “whether the Burnside and Dollar results hold (specifically whether aid has a positive effect on growth when policies/institutions are good) is something of a red herring regarding the issue of selectivity. The idea that aid money directed to governments would be more productive if those governments had pro-development policies and institutions is very intuitive.”

Perhaps it is not surprising, then, that evidence indicates that donors have indeed paid increasing attention to the institutional environment of recipient countries ([Dollar and Levin 2006](#)). The World Bank, for example, allocates loans from its International Development Association on the basis of its Country Policy and Institutional Assessment. And the United States now allocates part of its aid through the Millennium Challenge Corporation, which has strict economic and political criteria that must be met before aid is granted to a country ([Radelet 2003](#)). The approach has become important and influential enough that the Development Assistance Committee of the OECD—the main group of bilateral donors—is concerned that some states will be “left behind” by donors ([OECD/DAC 2002, 2009](#)).

If the thrust of this paper regarding the similarities between foreign aid and natural resources is correct, the policy community might consider how to

formulate a “selectivity” approach to natural resources. After all, the lessons from foreign aid indicate that the disappointing performances of the current policy recommendations with regard to the “resource curse” are likely to continue. The implications of this approach, and some of the practicalities of it, are discussed in the next section.

A “Selectivity” Approach to Natural Resources

To begin the discussion of a selectivity approach to natural resources it is worthwhile to restate one of the most important points of the previous two sections. The literature reviewed above indicates that the economic and political environment determines the effects of both natural resource revenue and foreign aid. For well governed countries, therefore, the message of the literature is that if one takes the proper precautions—which are now fairly well known (Humphreys, Sachs, and Stiglitz 2007a) and illustrated by the countries discussed above—one need not worry about a “resource curse.” In fact, the evidence seems to indicate that well governed countries should expect to benefit from their natural resources. This is an important take-away from this literature review.

If the international community has a role in these countries’ use of their natural resources, it will be in providing necessary financing and helping them to implement best practices in terms of resource management. One of the important elements of these efforts should center on transparency. This element has been emphasized by the Extractive Industries Transparency Initiative (EITI), supported by the World Bank and other donors, which argues that oil companies and oil-producing governments should publish what they pay and receive during extractive industry transactions. The idea is to enable citizens in both selling and purchasing countries to make informed economic and political decisions.⁹ A similar focus on transparency is emphasized by the recent Natural Resource Charter, drafted by high-profile academics and practitioners, which attempts to summarize best practices with regard to resource management.¹⁰

However, given the discussion above about ownership and the importance of the governance environment in terms of the success of initiatives, the effectiveness of non-binding agreements such as the EITI is likely to be limited to those governments who for whatever reason want to use the resources well. In fact, 24 countries have pledged to adopt the transparency measures of EITI, but not a single one has fully complied (Ross 2008).¹¹ Again, there seem to be sharp limits to what can be accomplished by trying to get governments to change their behavior.

Obviously a key question from this perspective therefore is: How does one know when a government will use its natural resources in an effective way? This

question has in fact been a major focus for the donor community—obviously the very idea of selectivity implies that one must decide the basis on which evaluations of governments will be made. While at one point there was some agreement regarding the policies necessary for economic development, this consensus began to evaporate in the late 1990s (Stiglitz 1998), and even before the recent global financial crisis there were reasonable arguments that even looking for such a consensus might be misguided (Rodrik 2007). In the foreign aid context, Kanbur, Sandler, and Morrison (1999) have argued that this lack of consensus means that donors should decide for themselves what kind of policies they want to support. Since donors have different preferences over policies, each of them should support the countries that are closest to its preferences. As mentioned above, the United States has done this in the form of its Millennium Challenge Corporation, an agency that doles out part of the U.S. aid budget along criteria meant to reward what the United States considers to be good policy performance (Radelet 2003). Other donors have other instruments and criteria (OECD/DAC 2004).

It is useful in this light to think of a second group of countries. For any given donor, these countries are resource-producing but do not meet the donor's selectivity criteria. The message of the literature on aid effectiveness is that the donor should be quite skeptical that policy instruments can ensure that natural resources have economically and politically positive effects in these countries. The prospects of changing a government's policies are dim, and the ability of projects to spur development without a beneficial policy environment are similarly poor. In other words, it is highly unlikely that—from the donor's perspective—the resources sold by the producer country will have a beneficial effect for that country.

From a development perspective, the best option would seem to be “delaying extraction of resources below the ground until the country can reinvest the resources well above the ground” (Stiglitz 2007, p. 40). Given the political and economic incentives involved in trading natural resources, it is unrealistic to expect rich countries to close their markets to these countries.¹² However, there certainly seems to be no justification in the literature for helping these countries to develop their natural resources. In other words, donors might follow a “trade but no aid” strategy, in which they open their markets to natural resources from the producer countries but provide no financial assistance in terms of developing the resource sector. Obviously if the country's policies improve, so could aid from the donor, and even if the donor does not provide aid, it might still stay involved with the country in various ways, such as trying to help build capacity in the government where it is possible (OECD/DAC 2009).

Finally, there is a third set of countries that warrant attention here. These are the countries that produce natural resources but which the population in a given

purchasing country (or set of countries) views as having truly unacceptable policies. By “unacceptable,” I mean that the policies are so poor that purchasing countries may decide against even buying resources from these countries, despite the political and economic incentives pushing otherwise.¹³ Given the power of those incentives, this is likely to be an extremely small set of countries. Nevertheless, there are in fact important examples of purchasing countries pursuing this kind of approach.

Since 1997, for instance, the United States has prohibited American energy companies from trading with the Sudanese government. The Executive Order instituting these sanctions cited Sudan’s “support for international terrorism, ongoing efforts to destabilize neighboring governments, and the prevalence of human rights violations, including slavery and the denial of religious freedom.” Reflecting the focus on revenue highlighted in this review, Secretary of State Madeleine Albright said the sanctions were intended to “deprive the regime in Khartoum of the financial and material benefits of U.S. trade and investment, including investment in Sudan’s petroleum sector.”¹⁴ It is notable that the United States has continued this policy despite the fact that Sudan is able to sell its oil to other markets. Since 1999, the Sudanese government has received about \$500 million a year from petroleum exports despite the U.S. sanctions, much of it sold to China, which meets about 7 percent of its energy needs with Sudanese oil (Baldauf 2007). There is a close parallel here with the issue of selectivity in aid: Western donors have begun to complain about China’s aid policy in Africa, because China is giving aid to countries these donors would prefer did not receive it (McGreal 2007).

A second important example is the Kimberley Process Certification Scheme (KPCS) instituted by the United Nations to prevent diamond production from fueling rebel groups and human rights abuses in producer countries. The goal of the KPCS is to keep illegitimately produced diamonds out of the international market, an idea that arose out of research indicating that—like other natural resources—producing diamonds in certain environments had terrible consequences for the producer country.¹⁵ As a result of pressure from international NGOs, an agreement was reached between the major diamond trading and producing countries, the diamond industry, and NGOs to establish a diamond certification scheme. Though faults in the scheme may remain (NGOs like Global Witness and Amnesty International have argued that improvements are needed), what is important here is the basic principle: an international agreement exists to restrict the buying of an important natural resource for reasons of human welfare.

The Kimberley Process example indicates how NGOs and policy-oriented research helped to focus attention on how actions in rich countries encourage the negative effects of diamonds. The selectivity approach indicates that their efforts

might be focused more broadly. In fact, the development community is increasingly focusing not just on aid policies, but also on how trade, migration, and other policies affect developing countries. Perhaps the best known evaluation of these various policies is the Center for Global Development's Commitment to Development Index, which evaluates rich countries in terms of their contribution to development.¹⁶ Importantly, in the Index's evaluation of donors' aid policies, it downgrades countries for giving aid to corrupt and undemocratic regimes, but the analysis of rich countries' trade policies—particularly with regard to natural resources—includes no such devaluation. The approach presented here indicates that these policies may be just as important.

Conclusion

I have made two central points. The first is that recent work on natural resources strongly suggests that the “curse” of these resources—that they seem to result in worse economic and political outcomes—is a function of the institutional environment in which these resources are found and how the revenues are used. If the country in which resources are found is well governed, these resources can have beneficial effects. Given that we now know much about how to manage these resources, this should be encouraging news to well governed countries and the international community. As with any policy management, mistakes can be made even in well governed countries, but there seems to be no particular reason to fear a curse in these countries.

The second point concerns the problem that this first point raises—what can be done when natural resources accrue to poorly governed countries? To answer this question, I have drawn lessons for natural resource management from the existing literature on a resource that is similar in many ways: foreign aid. Unfortunately, the aid literature indicates that we should be skeptical about the ability of various policy “mechanisms” to insulate countries from the negative effects of natural resources. In poorly governed countries, there may be very little the international community can do to prevent these resources from having negative effects.

Because of this, I have essentially argued for a graduated approach—a “selectivity” approach—to interacting with countries that have natural resources. In well governed countries, the international community should help in the development of natural resources, particularly focusing on the lessons of successful resource-rich countries and emphasizing transparency of accounts. Just as with aid, the emphasis here should be on enabling the country to pursue an agenda it owns. For those countries that do not meet a donor's selectivity criteria for aid, it is unrealistic to expect the donor to stop buying the resources, but there seems to

be little justification (from a development perspective) for them to finance the country's resource sector. Donors will be tempted to use conditionality to improve the country's policy environment, but existing studies have generally concluded that there is no systematic relationship between conditions and policy reform. Finally, at the worst extreme in terms of governance, there is a serious argument to be made for not purchasing the natural resources.

The existing literature suggests that the use of this type of graduated approach should enable the greatest development impact from countries' natural resources. As mentioned at the beginning of this paper, this impact is potentially enormous. Natural resources do not have to be a curse—this much has become clear in the literature. If it continues to be one, it will likely be the fault not only of the countries with those resources, but also of the international community.

Notes

Kevin M. Morrison is Assistant Professor at the Department of Government, Cornell University; email address: morrison@cornell.edu. He is grateful to three anonymous reviewers, Pierre Jaquet, Emmanuel Jimenez, Mushtaq Khan, Tom Morrison, Akbar Noman, Tom Pepinsky, Michael Ross, Chukwuma Soludo, Francis Wilson, and Nimrod Zalk for comments, and particularly to Joseph Stiglitz for his encouragement and support. He is also grateful to seminar participants at Columbia University's Initiative for Policy Dialogue's Africa Task Force, Cornell University, and Stanford University. In no way does this imply that any of these individuals are in agreement with the paper or responsible for any errors in it.

1. These types of funds can also help with Dutch Disease effects if used properly.
2. For a less sanguine view of Botswana's development path, see [Hillbom \(2008\)](#).
3. To be sure, some remain skeptical that aid ever has a positive impact. See, for example, [Rajan and Subramanian \(2008\)](#).
4. It should be noted that while much academic and policy-oriented work has emphasized the benefits of this approach, many donors continue to deliver aid in more traditional ways.
5. Two instances where conditions seem to have helped a government with policy reform are documented by [Devarajan, Dollar, and Holmgren \(2001\)](#), who argue that, in the cases of Ghana and Uganda, leaders committed to reform welcomed conditions because they helped to signal the seriousness of their efforts. Nevertheless, generalizing from these cases is difficult, not least because deciphering the commitment of leaders is challenging.
6. The quotation is from the World Bank's website on the Chad–Cameroon pipeline: <http://go.worldbank.org/RQSFYMZPE0>.
7. The 2005 standoff is particularly indicative of the similarities between this experience and donors' experience with aid conditionalities. Chad was in the midst of political turmoil and approaching an election. Despite its qualms about Déby, the World Bank and its major shareholders probably preferred him to the alternatives, or to an unstable country ([Bank Information Center 2006](#)). The agreement to resume lending to Chad happened just after a U.S. State Department visit to the country, and just before the national elections. In sum, just as with foreign aid, a variety of conflicting interests rendered ineffective the attempts to make these resources promote development in a clearly anti-development environment.
8. It is notable that the "Management Response" to the report agreed: "A project of this sort *cannot* succeed without Government commitment and responsibility" ([Independent Evaluation Group 2009](#), p. xx).
9. See <http://eitransparency.org/>.

10. See <http://www.naturalresourcecharter.org/>.
11. In yet another parallel between natural resource revenues and foreign aid, similar transparency measures are being encouraged for foreign aid. For example, a website has been set up by the government and donors in Mozambique to publicize the details of aid the country receives (www.odamoz.org.mz). According to Oxfam America, the United States consistently fails to submit up-to-date information, and the website receives no information at all from China, Korea, Brazil, Russia, or India.
12. An interesting alternative would seem to be a market-driven solution, by which companies offer the equivalent of “fair trade” gasoline to those consumers willing to pay extra for knowing that the gasoline comes from responsible governments. I have, however, seen no discussion of this idea. I am grateful to Macartan Humphries for suggesting this to me.
13. See Wenar (2008) for an interesting treatment of this issue.
14. See <http://www.eia.doe.gov/cabs/sanction.html>.
15. See http://www.globalwitness.org/pages/en/the_kimberley_process.html.
16. See http://www.cgdev.org/section/initiatives/_active/cdi/.

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