

# AVOIDING THE RESOURCE CURSE – POLITICAL AND ECONOMIC, DOMESTIC AND INTERNATIONAL FACTORS TO FOSTER COMPETITIVE ARRANGEMENTS

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*“All industries but the oil industry have been neglected wherever oil has been discovered. The lure of quick fortunes has everywhere attracted men and capital from other industries. The steady and uninteresting operations of farming and merchandising, and even the professions . . . have suffered in comparison . . . men and capital much needed in other industries have poured into the oil fields . . . It is not only through speculation in leases that human energy has been wasted in the oil fields. Many capable and energetic people have been turned from productive labor by the “windfalls,” the unearned fortunes that abound in the oil fields”.*

John Ise (1928) *The United States Oil Policy*. New Haven: Yale University Press, p. 205,  
(Quoted in Goldberg et al. 2008, 498)

## Abstract

Once an economy starts to specialize heavily in the extraction and export of natural resources, several negative repercussions in the wider domestic economy tend to arise. Such problems are often described as the “paradox of plenty” or the “resource curse” and they have occurred both in developed and developing countries.

This paper summarizes the current debates surrounding the “resource curse” (RC) and highlights their major features, including a more systematic reflection of approaches to resource management and, particularly, resource governance arrangements. The sections summarize some of the key features of the RC, set out the specific institutional settings that are conducive to its occurrence, examine the delicate role of government and state-owned enterprises, *and* address the need for a complex and, at times, paradoxical set of interventions to induce domestic institutional change and avoid the RC. A number of references are made to the case of Mongolia.

## Introduction

Once an economy starts to specialize heavily in the extraction and export of natural resources, several negative repercussions in the wider domestic economy tend to arise, such as an appreciation in the exchange rate and a bias against industrialization and economic diversification. Such problems are often described in textbooks as the “paradox of plenty” or the “resource curse” (RC) and they have occurred both in developed and developing countries.

While developmental problems in resource-abundant countries are well known, there are several disagreements in the literature when it comes to questions of “correlations”, let alone “causality”: Are developmental problems due to the RC, or is the RC due to develop-

mental problems? There is also little agreement on what can be done to escape the RC and why some governments have been more successful avoiding developmental problems than others. What is missing, in particular, is a link to the rich public policy literature on (resource) governance that has emerged during the last few years.

This paper summarizes the current debates and highlights their major features, including a more systematic reflection of approaches to resource management and, particularly, resource governance arrangements. The paper proceeds as follows: *Section 1* summarizes some of the key features of the RC; *Section 2* sets out the specific institutional settings that are conducive to the RC rather than those that avoid it; and *Section 3* focuses on the delicate role of government and state-owned enterprises. *Section 4* addresses the need for a complex and, at times, paradoxical set of interventions to induce domestic institutional change and avoid the RC.

## **1. The Resource Curse – its Major Features**

There has been intense debate over the last two decades concerning a paradox previously recognized in Adam Smith's "Wealth of Nations", that societal wealth based on the exploitation of a country's natural resources may be short-lived and fragile (Smith, 1999, 143). Concerns about economic growth and diversification have been raised in other historical contexts (Bauer & Quiroz 2013, 245), and also during the early decades of the US oil industry (Goldberg et al., 2008, 498). This debate has also included Mongolia (Moran, 2013; Gupta et al., 2015).

The debate on the RC largely consists of a series of economic and political research and relating narratives, with little exchange between the different scholars. On the one hand, while some economists, including Sachs and Warner (1997; 2001) and Auty (1994; 2001) stress that countries blessed with abundant natural resources in oil, gas and minerals puzzlingly often face serious economic problems, political scientists such as Ross (1999; 2014) and Barma et al. (2012), have highlighted the political repercussions of the RC and economic specialization.

Let me start with some of the key assertions regarding the economic repercussions of the RC that have been mentioned so far (cf. Gelb, 1988; Sachs & Warner, 1997; Sachs & Warner, 2001; Auty, 2001; Humphreys et al., 2007; Torvik, 2002; Torres et al., 2013):

- Countries with larger endowments of natural resources tend to have lower rates of growth over time than relatively resource-poor economies. In fact, success stories in development appear to be particularly evident in countries short of natural resources;

- The massive inflow of revenue from exports of natural resources, particularly during boom periods, leads to an appreciation of the real exchange rate that favors imports instead of local manufacturing, and crowds out non-traditional exports;
- The overall economy is heavily biased towards exports of raw materials with little or no linkages to other economic sectors. A “resource pull effect” of the dominant sector hinders diversification and technological progress in other sectors of the economy (and deepens “structural heterogeneity”);
- Given the price fluctuations of raw materials, economies specializing in such exports are likely to periodically go through cycles of economic booms and busts. While governments increase public spending and benefit from favorable conditions for foreign credit during the good times, they need to manage painful adjustments in spending and reduce public debt when prices of raw materials are low;
- Since income generated by the “enclave sector” is usually considerably higher than in other economic sectors, countries specializing in raw material exports usually have a higher income inequality;
- Raw material exploitation typically generates high “economic rents” which provides numerous incentives for public and private agents to engage (at times excessively) in “rent-seeking”;
- The full societal costs of raw material exports are often not sufficiently taken into account. First, since raw materials are assets that are being physically depleted, countries are living off their natural capital. Second, raw material exploitation often causes serious environmental damage. These two negative impacts are rarely reflected in the overall national accounts.

Moreover, once a country has a propensity for raw material exploitation and export, this has several political repercussions that also have an impact on domestic political structures (cf. Ross, 1999; Ross, 2014; Bannon & Collier, 2003; Robinson et al., 2006; Barma et al., 2012; Casertano, 2012; Ahmadov, 2014; Colgan, 2015):

- Governments that can finance their expenditures largely from taxes (royalties) imposed on the raw materials sector can reduce taxation, or even avoid taxing their citizens altogether. This has several political repercussions. First, governments that do not need to rely on their citizens’ financial support can neglect to seek their political support. Second, citizens who do not pay taxes do not have the same leverage in asking for something in return, for example accountability. Third, government legitimacy

does not derive from the consent of its citizens, but from providing them with “free” services. Fourth, the absence of a tax-benefit link allows for limited political freedom and leads to political under-representation and under-participation:

- Countries specializing in raw material exploitation are therefore often governed by political regimes that are either partly democratic or non-democratic;
- At times, governments have to deal with separatist movements in regions that are rich in natural resources;
- Countries with strong state ownership in the raw materials sector and little diversification in their economy tend to have high levels of state-led political development and bureaucratization;
- Rent-seeking favors class structures characterized by elitism, nepotism and favoritism. Rent-seeking not only favors corruption and restricts social mobility, it also leads to politically co-opted middle classes; rent is often used to expand public sector employment and with it political patronage.
- Despite the economic and social costs mentioned, a small but powerful elite (“state class”) benefits enormously from the existing arrangements. With little access to these exclusive circles, political rebellions and coup d’états become more likely, particularly during economic and fiscal crises. Greed and grievances in weak democracies can easily trigger violent political protest;
- While raw material price booms allow for generous public spending and political integration, periods of collapsing prices for exports need austerity measures and more attention to political disintegration – and coercion. Moreover, distributive struggles can deepen social tensions and raise political conflict.

In the case of Mongolia, Fritz (2014, 42) has stressed that especially during the 2000s “patronage links have been strong and embedded not only in political parties, but also in regional networks and business conglomerates – and the latter two also cut across party lines (...). Opportunities for conflicts of interest in the public sector were substantial and were not regulated. For example, there was no regulation of conflict of interest in mining licensing. Similarly, many politicians either had or developed interests in the construction sector, while the scale of public contracts rapidly accelerated”.

As we can see, it is difficult to separate some of the political implications of an economy based on raw material exports from the political foundations of such economic activities. Causality probably runs in both directions and has over time caused the formation of powerful

interest groups with little incentive to support changes in the status quo. Such features need to be carefully considered in any strategy for reform and to “avoid the resource curse” (see below).

## **2. A Curse of Resources or a Curse of Institutions?**

Several authors (e.g. Davis, 1995; Papyrakis & Gerlagh, 2003; Lederman & Maloney, 2007; Haber & Menaldo, 2011; Liou & Musgrave, 2014) have challenged some of the above assertions, stressing that the adverse economic and political effects of natural resources’ extraction and export only arise in the studies mentioned because of flaws in research design and methodology – selection biases, omissions, comparability problems, and shortcomings in large-n studies and regressions – or because of underlying conditions, such as the institutional environment, or only accounting for some mineral exports, for example oil but not coal. With no hard statistical evidence for a RC to occur, one is tempted to believe that resource-abundant countries might as well use their natural resource wealth to diversify and grow their economies, and become even more competitive and democratic over time.

There are three arguments that caution against such a hasty conclusion, mostly derived from current large-n studies. First, indicating that a scientific explanation – assertions about what is there, what it does, and how and why – does not withstand empirical testing is a serious statement. It is nothing more than a fundamental scientific step on the way to better explanations (Deutsch, 2011, 30-32). It does not mean that some of the economic and political problems mentioned above have just disappeared. They still exist, as I show in the next sections, and they give sufficient reason for concern for policy makers, businesses and citizens, both domestically and internationally.

Second, while cross-sectoral, cross-country time series, meta-analyses (Ahmadov, 2014) and other econometric studies have contributed enormously to a better understanding of the dynamic developmental patterns in resource-abundant countries, they may not (yet) be able to satisfactorily capture the complex processes of economic, political and institutional change that underlie each of these patterns over time. More comparative small-n studies or nested analyses (Lieberman, 2005) might be better suited to analyze and better understand why and how some countries have used their natural resources for the benefit of citizens, while others have not. A study by Goldberg et al. (2008) that has concentrated on the US and thus kept its analytical framework narrower, has traced the management of natural resources

by US state governments over a period of 73 years. It found some evidence for well-known RC features, particularly in Texas and Louisiana.

Third, we may need to ask different questions. Instead of asking implicitly how *resource-abundance* is related to, correlates with, and influences a country's economy and polity, or whether it matters *what* one exports, it may be more meaningful to ask how *societies* and *societal institutions* have shaped the use of natural resources or *how* one exports (Lederman & Maloney, 2012). In other words, there has been an overly strong focus on structure but less so on agency.

Fourth, and somewhat surprising for a public policy and political science scholar, most studies on the RC use the national economy, the nation state, the national government and the national polity as quasi-homogeneous units of analysis, thus neglecting possible explanatory factors beyond and below these levels. They often take neither *international* nor *subnational* actors and influence properly into consideration.

While there is an overwhelming amount of literature (for an overview see Rosser, 2006; Torres et al. 2013, Ahmadov, 2014, Ross, 2014) on such a contested topic, there are however some important areas of consensus. Most scholars would probably agree that (i) resource-rich countries and societies are not doomed to fail. In some cases, policy choices have triggered long-term growth, encouraged economic diversification and increased welfare; (ii) domestic structures and processes, particularly a country's political and economic institutions, are crucially important. They shape the incentives for domestic actors and how they make use of a country's assets – productively or not; (iii) more specifically, state capacity and government matter, including the government's capacity to constrain itself. In other words, if countries are capable of developing “good” domestic institutions and governance, they can avoid the RC and the numerous developmental and societal problems that come with it (Mehlum et al., 2006; Robinson et al, 2006; Collier & Goderis, 2007; Bakwena et al., 2008; IMF, 2010; Sarmidi et al., 2014). The questions that arise immediately are: how and under what conditions are such institutions and governance arrangements created, and what are their specific features? Is this just a domestic process or does the international level matter as well?

Before we follow up on some of these thoughts, particularly when it comes to avoiding RC and further developmental problems, I present some data to illustrate empirically what the current situation of raw material exporters looks like – and why it is important to look at who is in charge.

### **3. Why Ownership Matters – SOEs, NOEs and the Institutional Environment in Resource-Rich Countries**

Despite more than two decades of privatizations in the raw materials sector, state-owned enterprises (SOEs) still play a very prominent role. Indeed, several studies have indicated that SOEs have become more important in recent years in this sector, particularly in emerging economies. Among the 10 largest energy companies in 2013-2015, as measured by the oil and gas reserves they control, seven are owned and operated by governments: Saudi Aramco, Gazprom (Russia), National Iranian Oil Co., Rosneft (Russia), Petro China, Petróleos Mexicanos, and Kuwait Petroleum Co. While privately-owned multinational companies (MNCs), such as Exxon, BP, Chevron or Royal Dutch Shell only control about 10% of the world's oil and gas reserves, SOEs or national oil companies (NOCs) control some 73% of world oil reserves and some 61% of production (McPherson, 2013, 146; Dutta, 2013; Oil and Gas IQ, 2015). Similar trends towards a higher state engagement can also be observed in the non-oil minerals sector. This is particularly evident in the exploitation of strategically important “rare earths” where Chinese SOEs dominate the world market (World Bank, 2011, 2-5).

Given these impressive market shares in sectors that are critical for economic growth and development around the world, and given what we know already about the economic inefficiencies and the management of state enterprises (Boardman & Vining, 1989; World Bank, 1995 and the x- (in)efficiency debate in Leibenstein, 1966), there are also reasons for concern about the stability of supplies. Notwithstanding significant differences across sectors and countries, and that some enterprises have undergone serious management reforms, SOEs and NOCs often lack the competitive environment that encourages economic performance and effective control. Consequently, many of these companies have “proved to be irresistible targets for control by local elites in pursuit of personal or political gains” (McPherson 2013, 151) and have opened up a plethora of opportunities for graft and corruption.

Ownership structures in the raw materials sector in general, and state ownership in particular, are crucial components that have often been overlooked in the debate on the RC. Criticizing the empirical results of Haber & Menaldo (2011) covering most of the twentieth century, Andersen & Ross (2014), for example, point out that a clear distinction needs to be made between the international oil business up to the 1970s, when the “Big Seven” MNCs largely dominated the world market, and the transformative events of the 1980s, which allowed governments to increasingly capture oil and mineral rents. According to the authors, harmful outcomes (i.e. the RC) mostly come about “when the government has a dominant role in the oil industry” (Andersen & Ross, 2014, 1015) and when it faces a system of weak

checks and balances. Similarly, the research done by Jones & Weinthal (2006; 2010) and Weinthal & Jones (2006) on the oil sector's development in five Soviet successor states has stressed that resource abundant countries are cursed not by their wealth, but by the ownership structure they chose to manage their mineral wealth.

Given the incentives that public managers face in non-competitive environments, the capacity of NOCs to improve their performance is severely limited, and ownership structures cannot easily be changed. Such reforms are arduous and depend on the political will of policy makers who, paradoxically, are often part of the same patronage network that had once helped to expand politically motivated public sector employment (Robinson et al., 2006, 448, 464). There have been plenty of shortcomings, delays and setbacks in the management of such reforms, all of which remind us that such policy failure may indeed be fully rational under the existing conditions (I have spoken about "successful policy failure" elsewhere: Fuhr, 1994). Political economy scholars have emphasized that SOE reform:

"... disrupts social pacts and thus carries with it potentially huge political costs. Thus the potential gains must be large enough for regime leaders to be able to compensate some of the losers and/or to build alternative bases of support. Assuming there are net gains to be made, leaders face still another problem. Because the gains materialize later in the reform process while the costs are borne earlier, institutional mechanisms need to be established in order to make policy reversals costly. Only in this way can the gains and thus the compensations and benefits be guaranteed" (Campos & Esfahani, 2000, 237).

#### **4. Avoiding the Resource Curse – About the Economics and Politics of Reform and Paradox Interventions**

Despite the above-mentioned constraints, some governments and public administrations have indeed been able to initiate reform in their raw materials and export sectors, and have used the resources constructively for economic diversification and broader development over time (McPherson, 2013, 153). But why did some governments make it – for example in the OECD world – while others failed?

Similar to the debate mentioned in the first section, most strategies towards reform fall into either one of two groups. While economists have tried to come up with a series of sophisticated economic and financial measures to mitigate overall economic problems and define options for broad-based growth and development, political science scholars on the other hand have stressed the difficulties and the political economy of any such reform is due to the short-term interest of powerful elites that often dominate the political system.



In any case, the debate is complex and will lead from a discussion about very useful, yet rather technocratic solutions and recommendations to approaches that relate more explicitly to political science, international political economy, and public policy. As I will show, there is no easy way out and big bang approaches are unlikely to work.

The three sets of reforms that I have pulled together highlight different options to avoid the RC, all of which are based on incrementalism – with an explicit need for careful experimentation and a combination of strategies towards societal change. They also refer to a debate well known in public policy, and from studies on specific resource governance arrangements at different societal levels (see e.g. Bauer & Quiroz 2013).

The *first* set of reforms I would call *intra-governmental* reforms. Economists have not only given us very rich analyses of the numerous problems facing resource-rich countries, they have also provided us with hands-on recommendations on how to solve them. Humphreys et al. (2007, Concluding Chapter), IMF (2007, 2010), Mayorga Alba (2013) and Bauer & Quiroz (2013, 249-261) list, among others, the steps to be taken in order to avoid the RC and reach a more integrated management of the “Extractive Industries/ Natural Resource Value Chain”. Some of these measures require considerable political will and government capacity to get started; others try to start somewhere to iteratively support both:

- Transparent decisions regarding the exploitation of natural resources, for the award of contracts and issue of licenses; this encompasses the hiring of top professionals for “getting a good deal” with extractive firms;
- Regulatory arrangements and systems to strictly monitor the operations of companies, both domestic and international;
- Better mineral wealth and revenue assessments, adequate tax instruments for extractives, and an efficient and effective revenue collection, including better reporting<sup>1</sup>;
- Efficient and effective management of expenditures, in particular of large, volatile and finite resources. This includes the management of (third party) natural resources funds for savings, stabilization and development projects;
- Careful decentralization of government expenditures, combined with a functional centralization of the collection of revenues from natural resources;

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<sup>1</sup> Established by the UN in 2003, the Kimberley Process Certification Scheme (KPCS), for example, is supposed to ensure that revenues from diamond trade are not financing violence by rebel movements and undermine legitimate governments. KPCS also requires member countries to collect and publish data on mining and international trade in diamonds.

- Given finite, non-renewable natural resources: supporting investments towards sustainable development, particularly in the resource-rich regions of a country.

In the case of Mongolia, Fritz (2014, 49-51), the World Bank (2013, 57) and Gupta et al. (2015, 4) stress that the country would need to ensure fiscal stability (e.g. through its Fiscal Stability Law) and fiscal policy adjustment (e.g. by eliminating the numerous off-budget expenditures). It would also need to considerably improve the quality of its spending. Public investment, for example, “suffers from weak project selection and implementation, inadequate coordination between government agencies, and excessive power of the parliament to insert poorly designed projects in the capital budget. Moreover, lack of transparency and capacity in public procurement, and politically motivated contracts also result in a low efficiency of infrastructure projects” (Gupta et al., 2015, 5).

Indeed, all these more general recommendations aim to improve government; they are “technocratic” in nature and guided by the “idea that development problems can be subject to a technical or managerial fix” (Rosser, 2006, 567). They are, however, based on the idea that the government’s and, more specifically the public administration’s, discretion in the management of natural resources need to be constrained by specific institutional arrangements that have worked elsewhere, for example for regular reporting, monitoring and supervision. Declaring such hands-on advice to be apolitical and therefore replete with “technicist fallacies” (Adrian Leftwich quoted by Rosser 2006, 567), however, sounds overly academic. Such criticism appears to be far removed from daily development practices in which political economy analyses are fully recognized (Fritz et al., 2014). Improving and professionalizing government agencies entrusted with the management of natural resources is key to avoiding the RC. Yet, the critics are probably right that this is but one necessary step.

The *second* set of reforms relates to increasing *constructive pressure* on government and public administration (Fuhr, 2005), essentially through better-informed citizens and civil society organizations, and requirements of public and private entities to disclose data on their revenues and expenditures relating to natural resource extraction. In the governance literature, one would call such arrangements “resource governance with government”. Interestingly, however, this is not just a domestic issue within resource-rich countries.

Although these reforms are aimed to inform citizens and domestic NGOs about *their* government’s practices in resource extraction, it is current practice to involve international civil society groups and NGOs to foster that process within countries. This is particularly evident in

countries with authoritarian governments and countries with limited options (to date) for citizen participation and governmental control of the media. Such NGOs make use of multi-level politics, namely globalized links between citizens and consumers in OECD countries and citizens in producing countries, especially when OECD-based companies are involved in such transactions.

The Revenue Watch Institute (now the Natural Resource Governance Institute), for example, recommends a broad set of actions to improve information, reporting, accountability and transparency. The Institute has published the Revenue Governance Index<sup>2</sup> with details on the institutional quality with which a country manages its natural resources. Revenue Watch has also been linked to the Extractive Industries Transparency Initiatives (EITI) that was founded in 2002. Jointly with civil society groups and based on voluntary principles of disclosure, EITI has aimed to enhance the transparency of a country's revenue streams from natural resources. It also includes the transactions with and between extractive industries, which are asked to report their financial flows ("publish what you pay"). EITI has been very successful in Nigeria, where it "discovered" some \$4.7 billion in unpaid bills by NNPC, the country's national oil company, and some \$560 million in unpaid taxes by international oil companies. In Mongolia, the government has successfully complied with EITI standards, and also made significant strides in lowering corruption (Moran, 2013, 5).

Supported, inter alia, by the IMF and the World Bank, EITI's worldwide initiatives, however, have only been moderately effective so far (Bauer & Quiroz, 2013, 250, 255). Data quality is often poor and reporting practices are often slow. Nevertheless, EITI has contributed significantly to increasing the awareness of citizens and governments – both in mineral exporting as well as in importing countries. It has also triggered further legislation, such as the Energy Security Trough Transparency (ESTT) Amendment to the 2010 US Dodd-Franc Act (for financial system reform and consumer protection), and other similar reporting requirements in the EU and Norway.

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<sup>2</sup> The Resource Governance Index (RGI) "measures the quality of governance in the oil, gas and mining sector of 58 countries. These nations produce 85 percent of the world's petroleum, 90 percent of diamonds and 80 percent of copper, generating trillions of dollars in annual profits". (...) The RGI "assesses the quality of four key governance components: Institutional and Legal Setting; Reporting Practices; Safeguards and Quality Controls; and Enabling Environment. It also includes information on three special mechanisms used commonly to govern oil, gas and minerals – state-owned companies, natural resource funds and subnational revenue transfers. The Index finds that only 11 of the countries – less than 20 percent – have satisfactory standards of transparency and accountability. In the rest, the public lacks fundamental information about the oil, gas and mining sector. Even countries with generally satisfactory standards exhibit weaknesses in some dimensions. There is a major governance deficit in natural resources around the world, and the deficit is largest in the most resource-dependent countries, where nearly half a billion people live in poverty despite that resource wealth" (Revenue Watch Institute, 2013, 2)

“Publish What You Pay” and “Global Witness” are other examples of international “advocacy” NGOs that work to address typical problems relating to natural resource extraction, such as corruption, conflict and civil wars, poverty and human rights abuses worldwide. Both have worked in the areas of oil and gas, diamonds, gold, timber, cocoa and other natural resources. We are clearly talking about global (resource) governance arrangements here, and how they work in practice.

The *third* set of reforms is likely to be more contested. While civil society and NGO involvement, also in their globalized form, are considered almost intrinsically “good”, involving private companies proactively to avoid the multitude of problems associated with the RC is likely to be regarded intuitively “wrong” or, at least, perceived as being rather suspicious. Strengthening the private sector and fostering property rights and entrepreneurialism, however, seem to be quite powerful options. But they have so far received only little attention in the debate on avoiding the RC.

My key argument relates to an extended interpretation of modernization theory, namely that in “modern” societies “contestation” and “competition” have largely been institutionalized, and that such institutionalizations are also central to avoiding the RC. For example, independent citizens and their organizations have constitutional “rights” to constrain the arbitrary behavior of governments and private enterprises; the government ensures competition policies for private enterprises to enter and exit markets and guarantees property rights for regular market interactions; and private sector growth and competition policies over time advance citizens and middle classes that are independent from government patronage and capable of exercising their constitutional rights (with the latter being one of the constitutive features of a truly and effective “civil society”).

But how can such contestation and competition be introduced in economically and politically non-competitive environments in many resource-rich countries, and then be institutionalized? So far, we have focused on the potential political inputs, also at global level, such as citizen and NGO pressure towards governments and enterprises, both state-owned and private, to comply with rules of transparency, accountability and fairness. This is already quite a challenging list for domestic actors, since there are plenty of domestic veto players likely to stop such initiatives right from the beginning, justifying their resistance with measures taken against unwanted foreign or “Western” influence. But we have also omitted a second necessary input: the economic agents in such processes.

Jones & Weinthal (2006, 246) and Weinthal & Jones (2006, 42) have stressed that ownership structures in the extractive sectors matter and that privatization, particularly towards national owners, may be one option to break up the monopolies of governments and NOCs and gradually introduce competition. Privatizations, however, are all but easy to carry out, particularly in countries with well-established systems of favoritism and patronage. They can easily be derailed and – instead of amplifying the private sector base – create new privileges for already privileged people (see e.g. Humphreys et al., 2007, Ch. 1). But there are also numerous examples that – if done right – privatizations can be effective tools for deepening markets and improving competition (Fuhr, 1994), for example in the telecoms sector. In addition, deepening markets and improving competition could, over time, lead to the emergence of new social classes, particularly entrepreneurial middle-classes, that are critical ingredients for gradually diversifying the economy *and* the society (Fuhr, 1994).

Another crucial condition for governments to improve their NOC's performance seems to be a feature we already know well from the "Asian Miracle". It was market-friendly policies and the government's ability to have their SOEs and mixed enterprises gradually face competitive economic pressure, particularly from the international private companies, that mattered eventually (Campos & Root, 1996, Ch. 6). Although "openness" is often not enough (Birdsall & Hamoudi, 2002), it can help.

Jones and Sierra (2013) have shown that internationalization of NOCs can help to improve their institutional capacity and performance, particularly in those NOCs that have adopted techniques and best practices directly from international private oil companies. But internationalization has often been constrained by domestic politics and has been tied to the legacy of its specific mode of emergence.

In the case of Mongolia, its strong economic interactions, particularly with Russian and Chinese SOEs, are likely to point in a different direction. Instead of strengthening and diversifying private sector development, they seem to be strengthening traditional state-led development policies with all their inherent weaknesses.

There is more detailed support and scattered evidence for an argument in favor of strengthening the private sector in resource-rich countries. While Kolstad's study (Kolstad, 2009, 441) indicates that only improved private sector institutions alleviate the effects of the resource curse, Hodler (2006, 1375) shows that stable property rights are key (Hodler 2006, 1375) and Baland & Francois (2000, 528) highlight that more entrepreneurship can effective-

ly crowd out excessive rent seeking. Analyzing the case of resource-rich Indonesia, Rosser (2007, 53) stresses that “the political victory of social forces that promote and develop capitalist economic relations (to be) an important prerequisite for overcoming the resource curse”. Rosser (2006, 567) has also emphasized that the external environment, geo-political and geo-economic features can positively influence domestic political and social transformations in resource-rich countries.

## **5. Conclusion**

There have been numerous studies in the past few decades that have empirically highlighted the key features of a RC in countries blessed by natural resources. Yet, the same amount of studies has shown just the opposite, by rejecting some of the arguments and providing empirical evidence to the contrary. Despite such differences, most scholars however would agree that (i) resource-rich countries and societies are not doomed to fail. In some cases, policy choices have triggered long-term growth, encouraged economic diversification and increased welfare; (ii) domestic structures and processes, particularly a country’s political and economic institutions, matter crucially. They shape the incentives for domestic actors and how they make use of a country’s assets – productively or not; (iii) more specifically, state capacity and government matter, including the government’s capacity to constrain itself.

Avoiding the RC effectively requires three different yet interconnected sets of institutional reforms. They consist of difficult and, at times, paradoxical interventions within resource-rich countries, such as (i) the establishment of arrangements that gradually introduce “competition” within the public sector, basically by introducing rules and restraints; (ii) a strengthening of citizens and civil society organizations and rights for their involvement in public policies; (iii) effective privatizations and improvements in the overall conditions for private sector development. Since initially “weak” domestic actors cannot easily introduce all these changes on their own, external actors, both state and non-state, may be needed. Provided there is a careful and thoughtful assistance strategy (cf. Fritz, 2014, 60-62), external actors can help to strengthen domestic actors, provide transitional finance, and help tilt the balance towards reform-minded groups that are genuinely interested in domestic institutional change.

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## **Abstract**

There have been numerous studies in the past few decades that have empirically highlighted the key features of a “resource curse” (RC) in countries blessed by natural resources. There has been a similar discussion on Mongolia as well. While RC problems are well known, there is little knowledge about how to avoid them and why some countries have been more successful avoiding them than others.

Avoiding the RC effectively requires three different yet interconnected sets of institutional reforms. They consist of difficult and, at times, paradoxical interventions within resource-rich countries, such as (i) the establishment of arrangements that gradually introduce “competition” within the public sector, basically by introducing rules and restraints; (ii) a strengthening of citizens and civil society organizations and rights for their involvement in public policies; (iii) effective privatizations and improvements in the overall conditions for private sector development. Since initially “weak” domestic actors cannot easily introduce all these changes on their own, external actors, both state and non-state, may be needed. While Mongolia has concentrated on some features of (i) and to a lesser extent on (ii), it has largely omitted reforms in area (iii).