Natural resources, institutions and economic development

Abundance in natural resources can have both positive and negative effects on a country's economic performance. Conventional wisdom would regard natural resources as an asset for economic growth, but during the last three decades the notion that natural resources are a curse rather than a blessing has become common in the economic literature.

The resource curse has economical, political, institutional and social dimensions. In this study I try to demonstrate that in countries with a fractionalized social structure the abundant natural resources are a curse rather than a blessing since many conflicts of interest emerge. If the number of fighting groups is high, the allocation of the entrepreneurs into those that fight and those that produce becomes crucial. The windfall gain over resource rents will be less than the loss in productivity caused by misallocations of labour.

The politicians tend to over-extract the natural resources to buy loyalties in their constituencies by discounting the future. Resource booms boost the chances of an incumbent retaining power after an election. By disposing more resources the politicians influence the outcome of elections. The countries with effective institutions that are producer friendly and promote state accountability draw benefits from resource booms while countries with weak, grabber-friendly institutions are affected by the resource curse.

Resource booms give economic agents a false sense of security. The agents have a higher preference for current consumption compared to future consumption. The urgency to make savings in order to create development potential is disregarded. Lower savings lead to a decline in investment a lower level of investment inhibits economic growth and creates inequity and poverty.