

---

# Business Environment In China

## What is the resource curse?

The definition of "Resource Curse" is a country with an abundant non-renewable natural resource, such as oil, gas or minerals. People will think that the economic situation in these countries is definitely better than in other countries. Because they have blessings from nature. But the truth is the opposite. The economic growth of these countries will raise sharply at the beginning and keep raising in a very short period, after that it was stuck here or even suffered a depression. "Resource Curse" is a famous proposition in development economics. It referring to economic and social issues related to mining resources. Rich natural resources may be a curse of economic development rather than a blessing, and most countries with abundant natural resources increase more slowly than those with lack of resources. The basic idea is that rich resources tend to hinder rather than promote economic development. This phenomenon occurred during the 1950s and 1960s, especially in the 1980s. A lot of resource-rich countries only gained a lower economic growth.

In 1993, a British economist Richard Auty launched the conception "recourse curse" during his investigation of economic development in countries with rich mineral resources for the first time. This conception held an idea that sometimes-abundant resources did not have a positive impact on economic development but limited its expansion. And in 1995, America economist Jeffrey D. Sachs and Andrew M. Warner published article 'Natural resource abundance and economic growth' for empirical test of this hypothesis. They selected 95 developing countries as samples to measure the annual growth rate of the GDP of these countries from 1970 to 1989. From the test, they think that resources restrained growth. Jeffery called "One of the surprising features of economic life is that resource-poor economies often vastly outperform resource-rich economies in economic growth." (Sachs, 1995) And he pointed out that if human can fixable use of natural resources, which can build a strong foundation for human resources, technology and infrastructure investment to keep growth.

## Why rich resource is curse?

Economists' observations have shown that countries with abundant natural resources cannot effectively make use of this gift. And the economic development of these countries is often behind in countries lack natural resources. In our impression, Africa is one of the poorest countries in the world. But they have wealthy natural resource. Such as copper, oil production, gas production. However, between the early 1960s and 1990s, the "Asian Tigers" which have small territory and limit natural resources have experienced rapid industrialization and maintain a high economic growth rate (more than 7% per year). By the early 2000s, these four countries have developed into a high-income economy.

The international economists have formed number of different perspectives to explain and solve this economy problem. But they both consider that the resource curse comes from people themselves, not from nature. There are lots of related factors, such as government corruption, the taxation of export and import, limits investment in industries and technology, exchange rate appreciation and depreciation. And the most important point is that some people only enjoy this

---

gift and ignore innovation. They fail to take advantage of this wealth resources to improve their economy in their own country.

## The Empirical Evidence

The dutch disease model was firstly presented by W. Max Corden and J. Peter Neary in 1982, which can be considered a main resource curse model. The two economists assumes that a small open economy can be divided into three sectors. There is a non-tradable sector including services and construction as well as a tradable natural resources export sector and a tradable manufacturing export sector. Two different effects in the economy arise from the real exchange rate appreciation by Dutch Disease theory. The real exchange rate is defined as the relative domestic price of non-tradable goods in terms of the foreign price of tradable goods. As the prices of tradables are set internationally, a real appreciation implies a fall in real exchange rate when the prices of non-tradable goods rise. The spending effect comes into play when a natural resource boom attracts a large capital inflow of foreign exchange and triggers higher domestic aggregate demand and spending. Larger domestic demand for the non-tradable sector increases in the relative price and output in the services sector. However, the world demand will not be affected by the increased demand in small economy.

The price of tradable goods tends to remain unchanged or at least does not grow as much as the price of nontradables. The price difference appreciates the real exchange rate, therefore making tradable manufacturing goods more expensive for other countries to buy. The increased price of nontradables also increase wages in this sector, leading to labour reallocation from manufacturing sector to services sector. The resource movement effect occurs when a boom from the natural resource sector increases demand for labor, which attracts labor and capital to shift away from the rest of the economy to the tradable natural resources sector. This shift tends to reduce production in the both non-tradable and manufacturing sector. When the production in the non-tradable sector reduces, the price of non-tradable goods will rise, therefore appreciating the real exchange rate and decreasing country's competitiveness on the world market in exporting other tradable goods. Finally, it undermines economic growth. Both effects lead to a fall in the export of the manufacturing sectors and an appreciation of real exchange rate, which have an adverse effect on economy and hinder long term economic growth.

There are some empirical studies providing support to a negative link between resource abundance and economic growth. In 1995 Sachs and Warner showed regression evidence for natural resources curse after controlling for popular variables that considered for economic development, such as initial income, openness to foreign investments, rule of law, and changes in terms of trade. They found a negative correlation between the resource abundance and economic growth, and came to conclusion that during the period 1970-1989 countries that economies rely on high natural resource exports tended to have slower economic growth rate.

During the 20-year period resource-abundant countries had much slower economic development than resource-poor countries did. None of the countries with extremely high natural resources export in 1970 had vigorous growth for the next 20 years. Moreover, majority of the economies that grew rapidly during this period were considered resource poor instead of resource abundant. Recently, Ismail presented a stronger evidence of Dutch Disease in 2010. He studies the impact of oil price shocks and implications of Dutch Disease using disaggregated manufacturing sector data from a large number of countries and applying Heckscher-Ohlin

---

factor endowment model. Ismail built a proposition that a positive windfall shock leads to the shrink of manufacturing and the expand of non-tradable sector. He tested the proposition and revealed that a 10 percent increase in an oil windfall, on average, decreases value added across manufacturing sectors by 3.4 percent and reduces industrial output by 3.6 percent.

## Revenue Volatility

Besides of the Dutch Disease, revenue volatility is another feature for countries with abundant natural resources. The volatility of income mainly comes from three resources, the variation over time in rate of extraction, the variability in the timing of payments by corporation to states, and the fluctuation in the value of nature resource produced. A typical pattern for resource production is to have a front-loading of extraction rates since production volumes tend to reach a peak within the first few years of production and then gradually descend until production stops. The changes of extraction activities lead to unstable earning situation. The second major source of volatility derives from the nature of the agreement between the resource producing companies and the government. Nowadays, in some African countries, the oil revenue was exempted from taxes on the earning for beginning periods of production. Since taxes constitute a major source of government earnings, so the implementation of taxation will benefit government earning and income will achieve a sharp rise in certain time. The third major source of volatility is due to fluctuation of oil price over the past few decades. The picture (Figure 2) shows the world oil prices fluctuation from 1986 to 2014, although there is a clear upward trend over these years, the variation within each year is around plus or minus 5 to 10 percents, then the global price changing has a huge influence on domestic production earning.

## Solution

In nature resource industry, due to the nonrenewable conditions, any consumption of sale should be considered as the consumption of capital rather than consumption of income. If all revenues are consumed in each period, then value of countries' total capital declines. From the recent news, we could conclude that the resource curse is theoretically not inevitable, and there are countries with nature-based economy that do not exhibit regression tendency. Firstly, for resources-based countries, after gaining large amount of revenue, it is possible to convert most of nature resource stock into financial assets, investing assets in a diversified portfolio. For example, purchasing dollars, gold, overseas property, selling oil rights in future market can help countries to convert their income for long term using.

Furthermore, the dutch disease effects can be minimized if resources-based countries develop absorptive capacity to transform resource revenue inflows into intangible investment, such as roads and electricity, accelerating industrialization, generating non-resource sector economic growth, changing the original industry format which solely dependent on exporting raw materials. Additionally, developing on original resource bases, countries need to upgrade technological and infrastructure within resource sectors-extending resource endowments, processing innovation. At the same time, investors can develop the upstream and downstream industries, turning linkages into "development blocks". Sweden is a successful case that reforming its original timber resources, achieving products innovation and specializations, nowadays, the country has high reputation on exporting advanced building materials, flooring, and furniture.

---

Last but not least, from politic side, it is necessary to increase regulatory cooperation. The institutions regulatory is weaker in resource-rich countries since it's easy for participants to capture and take extra amount of revenue. For example, the oil project, which is large single-point sources of revenue, can be managed outside the normal budgeting process. Participants use tools such as sovereign wealth funds, nation oil gas companies, and contractors for extractive operations to capture extra cash. To combat corruption and disorder within industry, government need to work with international initiatives. For instance, The Extractive Industries Transparency Initiative (EITI) aims to improve revenue management in thirty rich resource-based countries, fighting corruption from government. Also, for envisaging corruption, one idea is to set up domestic oil fund, in order to keep harmful effects outside national economies, curb the Dutch Disease and smooth out revenue volatility. To have better communication with citizens, government need to improve transparency, which will enable citizens to call their government to account, giving their changes to debate the financial and taxation systems.

## References:

1. Atinc, Tamar Manuelyan. "Avoiding the Resource Curse: How to Manage Natural Resource Wealth for Human Development." Brookings, Brookings, 29 July 2016.
2. Akylbekova, Dina. "Analyzing the Resource Curse theory: A comparative study of Kazakhstan and Norway." (2015).
3. Civittolo, David, et al. "Contributing Factors to a Boomtown Bust." Ohio State University Extension, 23 June 2016, [ohioline.osu.edu/factsheet/cdfs-sed-3](http://ohioline.osu.edu/factsheet/cdfs-sed-3).
4. Ismail, Kareem. "The Structural Manifestation of the Dutch Disease': The Case of Oil Exporting Countries." (2010).
5. Mittelman, Melissa. "The Resource Curse." Bloomberg.com, Bloomberg, [www.bloomberg.com/quicktake/resource-curse](http://www.bloomberg.com/quicktake/resource-curse).
6. Patrick, Stewart M. "Why Natural Resources Are a Curse on Developing Countries and How to Fix It." The Atlantic, Atlantic Media Company, 30 Apr. 2012, [www.theatlantic.com/international/archive/2012/04/why-natural-resources-are-a-curse-on-developing-countries-and-how-to-fix-it/256508/](http://www.theatlantic.com/international/archive/2012/04/why-natural-resources-are-a-curse-on-developing-countries-and-how-to-fix-it/256508/).
7. Pettinger, Tejvan. "Resource Curse." Economics Help, [www.economicshelp.org/blog/glossary/resource-curse/](http://www.economicshelp.org/blog/glossary/resource-curse/).
8. Stijns, Jean-Philippe C. "Natural resource abundance and economic growth revisited." *Resources policy* 30.2 (2005): 107-130. Sachs, Jeffrey D., and Andrew M. Warner. "The curse of natural resources." *European economic review* 45.4-6 (2001): 827-838.
9. Sachs, Jeffrey D., and Andrew M. Warner. *Natural resource abundance and economic growth*. No. w5398. National Bureau of Economic Research, 1995.
10. Vostroknutova, Ekaterina, Milan Brahmabhatt, and Otaviano Canuto. "Dealing with Dutch disease." *Economic premise* 16 (2010).