



Abundant Resource Endowment: A Basis for Successful Economic Diversification

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I Introduction

It is widely accepted that achieving sustainable economic growth and development for resource-based economies requires economic diversification. An economy is said to be diversified if it has reached a level of industrial and economic development in which “no sector of the economy may be singled out as a dominant engine of economic growth.” For many resource-based economies, such as those based on minerals or agriculture, this economic diversification appears to have been elusive, prompting some analysts of resource-based development to argue that resource-based economies are hard to industrialize and diversify. This policy brief argues that the “resource curse”, although widespread, is not inevitable, because abundant resource endowment also provides advantages that can enhance the potential for economic diversification when appropriate policy choices are made.

This policy brief discusses the reasons for pessimism in resource-based economic development, resulting in failure to achieve economic diversification and sustainable economic growth. It then looks at why resource abundance can support successful economic diversification. Finally, the policy brief outlines the policies that result from the two scenarios and concludes that there is reason for successful economic

diversification in resource-based economies provided appropriate policies are chosen and implemented.

II Resource-based economic development – the pessimistic view

For some analysts of resource-based economic development, failure to achieve economic diversification has almost become a stylized fact. To a large extent this reflects the experience of a significant number of resource-based developing economies over the past five decades, especially those in Africa, which have failed to diversify and whose general economic performance has in many cases been dismal; there is much empirical evidence to support the “resource curse” hypothesis. As a result, many writings that appraise economic growth in resource-based economies focus on the reasons why economic diversification is more likely to fail than why it is more likely to succeed.

A number of factors can be identified that hinder the diversification of resource-abundant economies:

- Dutch Disease: resource exports from a booming sector lead to an appreciation of the real exchange rate, whether through nominal exchange rate appreciation or increased inflation. Such real appreciation in turn makes other tradeables sectors of the economy uncompetitive internationally – these

may be the manufacturing sector and/or the agricultural sector.

Inappropriate use of government revenues: booming resource sectors are typically taxed highly, especially minerals, as governments attempt to capture the rents involved, and government revenues are typically high as a percentage of GDP. With inadequate public expenditure management, these resources are often allocated in an inappropriate manner. The main problems that arise are excessive consumption; insufficient savings; and corruption.

Excessive consumption: the sale of mineral resources represents the sale of a nation's assets, and as such should be used to finance the accumulation of other forms of capital, whether human capital, physical infrastructure, or financial assets. Instead, resources are devoted to consumption spending, with little or no lasting benefit in terms of investment in assets. Even where resources are devoted to investment, inadequate planning often leads to expenditure on unproductive, white elephant projects.

Inadequate savings: it is generally agreed that the optimal response to a resource boom involves saving part of the proceeds in a financial form (and thereby building up a financial asset to provide income when the resource boom tapers off, whether through foreign exchange reserves or an offshore investment fund). This has often not been the case, however, and some countries have even moved in the opposite direction by borrowing on the basis of future revenues and building up excessive debt. A failure to save from mineral revenues can also lead to problems of absorptive capacity, resulting in inflation.

Conflict and corruption: there is a well-established relationship between mineral

revenues and corruption, suggesting that countries with mineral resources are more prone to corruption, and the rent-seeking behaviour and waste of resources that this represents. Mineral rents can also induce discord and conflict among domestic stakeholders, which can undermine governance and lead to policies that waste revenue from resources.

In Botswana's case, while overall economic performance has been good over a prolonged period of time, with high growth rates and rising per capita incomes, diversification has not succeeded, and the continued concentration and dependence on the diamond sector exposes the economy to a variety of risks.

The above problems in resource-based economies can create a short-term approach to economic development which lacks careful and well-thought out economic planning and implementation of development projects. As a result, planned projects fail to achieve intended outcomes. Consequently, abundant resource endowment is often viewed as an "economic curse," that is, an impediment to economic growth and development in its own right. This view creates uncertainty and a lack of faith concerning the actual/potential success of the planned policies even among policy makers. This pessimism stifles creative and innovative thinking about the path of industrial development and economic growth that a country should follow. However, such a negative path for resource-endowed economies is not inevitable. Inappropriate policy decisions are not inevitable, and there are better and more rewarding alternative ways of responding to resource abundance.

III Resource-based Economic Development – the optimistic view

Contrary to the preceding view, resource-based economic development can be viewed from an optimistic perspective; the negative processes outlined above are not inevitable outcomes. This

optimism comes from the fact that resource-based economies have special advantages which, if strategically harnessed can lead to long-term economic growth and development. These advantages include:

- Ability to Close the Foreign Exchange Gap – many developing countries suffer from lack of economic growth due to shortage of foreign exchange for the importation of the necessary capital for industrial development. The exploitation of resource endowments like minerals and some agricultural cash crops generates foreign exchange which may help to close the foreign exchange gap that would have otherwise inhibited industrial development. Therefore, resource abundance would in this case be compatible with industrialisation.
- Healthy Balance of Payments (BOP) – excessive importation, without a concomitant increase in exportation leads to an imbalance in the BOP resulting in BOP deficits and pressure on the exchange rate. Exportation of resource endowments like diamonds, gold, oil and cash crops like cotton has helped many countries to achieve a positive BOP position, which can help to stabilise the exchange rate.
- Availability of Resources to Initiate Industrial Development – for many developing countries, efforts to diversify the economy are hampered by lack of resources to assist firms with the required infrastructure like roads and factory shells and financial incentives which may take the form of subsidies and tax rebates. Government revenue from taxation of the resource sector may be used to close these gaps and thus contribute towards industrial development. Further, the resource sector may lead to the development of backward and forward linkage industries.
- Availability of Resources to Finance Education, Public Health and Social Needs – resource wealth has been important in financing these public expenditures for many developing countries. For many countries without resource wealth to meet these needs, government is often alienated from the electorates, making the country susceptible to political instability and civil strife. Conversely, in countries where resource wealth has been used to meet these needs, peace and stability have generally prevailed.
- Human Resource Development – perhaps the most important use of resource wealth is in the area of expenditure on education. This is important as it develops skills that enable a country's population to find employment both inside and outside the country, especially in today's globalized world. Further, education can support the emergence of entrepreneurs, who might not have developed without government provision of adequate training and financing.
- Avoiding Unmanageable Debts – in their quest to achieve economic growth and development, many developing countries have in the past borrowed huge sums of money from developed countries to finance government budget and balance of payments deficits. However, due to a variety of problems, many of these countries failed to service their debts which plunged them into unmanageable debt crises which became an obstacle to economic development. On the contrary, resource-based economies that managed their resource wealth prudently, like Botswana, have not only avoided the debt trap, but have actually been able to create foreign reserves of many months of import cover.

The argument presented above shows that resource wealth, if properly managed, can lead to far more positive development process than is often the case. Thus a positive view of mineral wealth is important for a country to choose the right policies for economic growth and development. Hence it is also important to look at the policy choices under the two scenarios.

IV Policy Choice Under the Two Scenarios

Optimistic View	Pessimistic View
<ol style="list-style-type: none"> 1. Views resource wealth as a precious endowment in the control of government and its people to use for the long-term development of the country. 2. Because of 1 above, the optimist takes a long-term view of economic growth and development. Instead of suffering from the develop-quick, diversify quick and citizen empower-quick syndrome, the optimist emphasises: <ul style="list-style-type: none"> • Use of the proceeds of resource earnings for investment rather than consumption; • Careful project planning and implementation to achieve clearly defined development targets; • Strategic economic diversification based on sectors that have been identified as actual /potential engines of growth in the global economy; • Wise citizen economic empowerment plan based on innovation, business acumen, competitiveness and ability to deliver on the agreed product. 3. Because the optimist has a long-term view of economic growth, they are not prone to the construction of white elephant structures. 4. The long-term perspective means that government is able to resist interest group pressure to spend resource wealth on conspicuous consumption. 5. Further, with a long-term perspective, government can refuse to succumb to interest group pressures for rent-seeking opportunities. 	<ol style="list-style-type: none"> 1. Views resource wealth as precious but quickly passing wealth that needs to be spent quickly before disaster strikes. The ability of government and its people to use the resource wealth wisely is viewed with suspicion. 2. Because of 1 above, the pessimist takes a short-term view of economic growth and development. Consequently, their policies suffer the develop-quick, diversify quick and citizen empower-quick syndrome, which manifests itself in ill-conceived and poorly implemented development projects. 3. The short-term view of economic growth and development inherent in the pessimist approach leads to the construction of many white elephant structures, especially in years of elections when the voice of interest groups is precious. 4. From the preceding point, it is evident that a government that follows the pessimist view will be prone to succumb to interest group pressures. These often pressurise government to make economic policies that are prone to rent-seeking and conspicuous consumption of the resource wealth. 5. Government in this scenario is prone to succumb to interest group pressures in order to legitimise her stay in office. Favouritism, corruption and skewed distribution of income and geographical economic development occur in the country, leading to social and political instability.

V Conclusion

The major objective of this policy brief is to show that, contrary to the pessimistic view that abundant resource endowment is an “economic curse” that will make economic diversification hard, if not impossible to achieve, there are reasons why a resource-abundant developing country can achieve successful economic diversification. Resource abundance does not inevitably mean a negative development path; however, it will do so if inappropriate policy choices are made. Most importantly, the appropriate policy decisions involve taking a long-term perspective on development and the use of resources, and ensuring that governance processes are transparent and accountable. Some of the outcomes may not always be politically popular (e.g. save rather than consume). But a developing country that is endowed with abundant resource wealth like Botswana will do well not to focus on short-term pressures when determining policies that respond to the availability of resource wealth.

Erratum:

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