We Can Now Cure Dutch Disease
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There is a curious phenomenon that economists call the resource curse - so named because, on average, countries with large endowments of natural resources perform worse than countries less well endowed. Yet some countries with abundant natural resources do perform better than others, and some have done well. Why is the spell of the resource curse cast so unequally? Thirty years ago, Indonesia and Nigeria - both dependent on their oil - had comparable per capita incomes. Today, Indonesia's per capita income is four times Nigeria's. Indeed, Nigeria's (as measured in constant dollars circa 1995) has fallen. A similar pattern holds true in Sierra Leone and Botswana. Both are rich in diamonds. Yet Botswana averaged 8.7% annual economic growth over the past 30 years, while Sierra Leone plunged into civil strife. The failures in the oil-rich Middle East are legion.

Economists put forward three reasons for the dismal performance of some richly endowed countries. First, the prospect of riches orients official efforts to seizing a larger share of the pie, rather than creating a larger pie. The result of this wealth grab is often war. At other times, simple rent-seeking behaviour by officials, aided and abetted by outsiders, is the outcome. It is cheaper to bribe a government to provide resources at below-market prices than to invest and develop an industry, so it is no surprise that some firms succumb to this temptation.

Second, natural resource prices are volatile, and managing this volatility is hard. Lenders provide money when times are good, but want their money back when, say, energy prices plummet. (As the old adage has it, banks only like to lend to those who do not need money.) Economic activity is thus even more volatile than commodity prices, and much of the gain made in a boom unravels in the bust that follows.

Third, oil and other natural resources, while perhaps a source of wealth, do not create jobs by themselves, and often crowd out other economic sectors. For example, an inflow of oil money often leads to currency appreciation - a phenomenon called the Dutch disease. The Netherlands, after its discovery of North Sea gas and oil, found itself plagued with growing unemployment and workforce disability (many of those who could not get jobs found disability benefits to be more generous than unemployment benefits). When the exchange rate soars as a result of resource booms, countries cannot export manufactured or agriculture goods, and domestic producers cannot compete with an onslaught of imports. So abundant natural wealth often creates rich countries with poor people.

Fortunately, as we have become aware of these problems, we have learned much about what can be done about them. Democratic, consensual and transparent processes - such as those in Botswana - are more likely to ensure that the fruits of a country's wealth are equitably and well spent. We also know that stabilisation funds - which set aside some of the money earned when prices are high - can help reduce the economic volatility associated with resource prices. Moreover, such fluctuations are amplified by borrowing in good years, so countries should resist foreign lenders who try to persuade them of the virtues of such capital flows.

The Dutch disease, however, is one of the more intractable consequences of oil and resource wealth, at least for poor countries. In principle, it is easy to avoid currency appreciation: keep the foreign exchange earned from, say, oil exports out of the country. Invest the money in the US or Europe. Bring it in only gradually. But in most developing countries, such a policy is viewed as using oil money to help someone else's economy.

Some countries, notably Nigeria, are trying to implement these lessons. It has proposed creating stabilisation funds and, in future, it will sell its natural resources in transparent, competitive bidding processes. Most importantly, the Nigerians are taking measures to ensure that the fruits of this endowment are invested, so that as the country's natural resources are depleted, its real wealth - fixed and human capital - is increased.

Western governments can help with common-sense reforms. Secret bank accounts not only support terrorism, but also facilitate the corruption that undermines development. Similarly, transparency would be encouraged if only fully documented payments were tax deductible. Violent conflict is fed by western governments' massive sales of arms to developing countries. This should be stopped.

Abundant natural resources can and should be a blessing, not a curse. We know what must be done. What is missing is the political will to make it so.