Department of Economics

Group for Economic Analysis at Reading (GEAR)

Do natural resources and FDI tend to erode or support the development of national institutions?

By Grivas Chiyaba and Carl Singleton

Discussion Paper No. 2022-02
Department of Economics, University of Reading, Whiteknights, Reading, RG6 6EL, UK
https://www.reading.ac.uk/economics/

Non-Technical Summary

- This paper explores the relationships between natural resources, foreign direct investment (FDI) into developing countries, and the quality of national institutions, also known as "the rules of the game."

- We find negative and significant effects of natural resource use or extraction on the development of these national institutions.

- We focus on institutions such as legal and property rights, but these findings also apply to the quality of some other national institutions.

- Our results align with a theory that abundant natural resources lead to weakened institutions because of the potential for firms to secure their market position, power, and profitability.

- We also find that the effects of FDI inflows on institutional development are not significant after we consider them alongside the use of natural resources.

- This suggests that natural resource abundance tends to erode institutions in developing countries regardless of whether those resources are exploited alongside increased foreign investment into the local economy.

- The results imply that policymakers whose objectives are to strengthen domestic institutions should be wary (and possibly renew their resolve) when their countries develop new opportunities to extract rents from natural resources.

- In other words, governments would be advised to discourage, dismantle, or robustly regulate natural monopoly industries, which have strong incentives to invest in political pressure or other measures that can secure their powerful positions in the market.

- Botswana is one well-known example of a developing country that has successfully managed to regulate its natural resource sectors to avert these issues.

You can read the full paper here.