Policy Framework in Conditions of Resource Curse: Analyzing the Case of Norway and Venezuela

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ABSTRACT

The resource curse has been a developing field of study for researchers in economics since its origination in the 1990s .This paper studies the policy framework of Norway and Venezuela in dealing with the problem of resource curse emanating from the abundance of oil in both countries and the ensuing aftermaths. It analyses the post effects of their respective fiscal policies resource management techniques, and compares them on the basis of selected economic and socio-economic parameters. Through statistical observations, that are employed to analyze the differences in the handling of oil abundance, a conclusion is drawn on Norway's greater resource management over Venezuela's, to highlight Norway's case as a perfect example for other countries suffering from this 'resource curse'.

Keywords: Norway, Public Finance, Resource Curse, Venezuela

1. INTRODUCTION

Economic research on the relationship between resources and economic growth in the 1950s and 1960s suggested a negative correlation between the abundance of natural resources and economic development of countries, especially in the middle and lower income groups. The existence of natural resource abundance is hypothesized by conventional Economics as a prerequisite for economic growth. This contradictory observation, was name by Auty (1993) as 'The Resource Curse', to describe the dichotomy in the economic growth rate between countries that had higher growth rates in spite of being deficient in resources (Japan, Korea, Singapore etc.) and countries that had lower growth rates even when they were abundant in resources (Angola, Nigeria, Sudan etc). Empirical studies by Sachs & Warner (1995) affirm the existence of a strong correlation between poor economic growth and resources. Rent Seeking is considered to be a strong reason for the occurrence of the Resource Curse. Teng (2013) used a formal model to emphasise on the impact of rent seeking on production, and that more often than not, production output through usage of natural resources is a function of rent seeking effort. Currently, IMF identifies 51 countries as 'resource rich' with Venables (2016) recognising 29 of these identified countries suffering from the resource curse. Frankel (2010) postulates six factors responsible for the sub-par economic performance in spite of commodity wealth. Coming up with measures to counter the resource curse is a problem that is currently faced by policy makers and researchers. Despite understanding the causes, policy makers have been baffled by the existence of the resource curse and aim to find a long-term solution to it. While studies on African economies do not provide consensus among researchers as to what a plausible cure to the resource curse would be, the Scandinavian

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country of Norway seems to have outdone the effects of the resource curse to establish itself as a study in isolation. From the discovery of oil reserves in 1960 to the establishment of the petroleum fund, the judicious management of the oil resources reflects the view of Norwegian decision makers of national ownership of the resources that the development should be beneficial to the society as a whole. On the other hand, Venezuela perishes in its management of the same resource abundance of oil. The Venezuelan case has been marked by diminishing GDP growth and reducing economic standards even though it has the largest oil resource in the world. This can be attributed to a number of factors. As such, it seems pertinent to compare the two oil-rich economies to bring to light the policy differences on the management of the resource curse. The subsequent sections of the paper focus on drawing out parallels and contrasts between Norway and Venezuela and measuring the effects of various initiatives undertaken by their respective governments after reviewing the existing literature on the resource curse management in the two countries.

2. LITERATURE REVIEW

Gruben & Darley (2004) focus on the presence of resource curse in Venezuela and the factors responsible for it. The torpid nature of the government in bringing about economic initiatives led to the creation of a vicious cycle encroaching the economy. The authors have done a comparative study of Venezuela with the other Western Hemisphere oil rich countries to highlight its poor growth. A conclusion is derived that in spite of the abundance of oil reserves, the economic struggle from the 1990s has continued and persisted for the worse due to political ineptness. Rossi (2011) further highlights that in spite of the profuse oil wealth of Venezuela; the monetized revenues of its oil wealth have not brought prosperity to the economy. He presents a detailed historical summary, coursing from the discovery to the present day abundance of oil in the country, to substantiate how the massive oil wealth rent has in effect contributed in rendering the economy into an unproductive society. The paper evaluates the elements that have fuelled the interplay of the Resource Curse and provides a unique insight on the political scenario of the country. Using descriptive and statistical methodologies, the author illustrates the failure of Venezuelan socialist model of development concluding that Venezuela must adopt suitable political and economic measures to deal with the resource curse and move towards productivity.

On the other hand, Havro & Santiso (2008) focus on the experiences of Norway (oil) and Chile (copper) to illustrate that effective resource management can convert the natural resource curse into a blessing. They decode the mechanism of the paradox of plenty and analyse its implication on the countries with poor development indicators through effective statistical means. The authors present an in-depth study of the various elements ranging from fiscal prudence to government involvement and institutional quality responsible for the success of both Norway and Chile in overcoming the curse, thereby providing valuable lessons for other resource wealthy nations. Through this case study on Norway's and Chile's economic policies, the authors substantiate the need and the role of theinternational development community and technical co-operation with regard to both oil and copper related endowments. This is synchronous to Larsen(2004) who states that as a result of the economic strategies, Norway was able to attain accelerated growth post-oil discovery unlike the other oil-rich countries and was able to surpass the other Scandinavian countries. He argues that Norway managed to escape the resource Curse and the Dutch Disease from the mid-70s to the mid-90s not because of structural adjustment but because of the implementation of unconventional foresighted policies formulated by the policy makers. However, the paper does mention that some signs of the resource curse seemed visible in the

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late 90s, which he attributes to the political state of affairs. A further analysis conducted by Holden (2013) isolates the factors and policy measures in Norway undertaken in respect of its abundance of petroleum to prevent the resource curse that plagued other nations in similar resource abundance conditions. Timelining the Norwegian case from the discovery of oil resources in the 1960s to the establishment of a fiscal policy of oil revenue spend in 2001, the paper critically analyses the role of an active political system working in consonance with a prescient central bank and efficient state bureaucracy in effectively navigating Norway from the curse of abundant oil resources. Employing a methodology of statistical and descriptive analysis, the author has summed up Norwegian case and its employment of prudent fiscal measures and investment strategies such as creation of a pension fund investing in overseas assets in varied proportion and the promotion of state deficit financing using such real returns to be an ideal model for other countries to learn from for avoiding the resource curse.

3. RESEARCH OBJECTIVE

This paper aims at a case study comparison between the two countries Norway and Venezuela which faced the resource curse throughout the 20th century by the abundance of oil. It is facilitated by a descriptive analysis of the policy measures and their implication as measured by economic and socio parameters. As such the primary objective of the research paper is:

"**To comparatively analyse the resource curse management in Norway and Venezuela"**

4. COMPARISON BETWEEN NORWAY AND VENEZUELA

Both Norway and Venezuela have identical timelines of their discovery of petroleum. The respective management of the two countries are explained as under:

Norway

Norway serves as an ideal example of a country that was productively able to combat the resource curse. Competent management of the resource, efficient revenue collection mechanism and fiscal stability coupled with the country's well established democracy, outward looking policies and corruption-free institutions helped Norway in accelerating its growth and development.

Norway's crude oil reserves, as of 1st January 2015, amounted to 6.4 billion barrels. The petroleum sector is the largest contributor to the country's revenues. It contributes 22 percent to the GDP, 27 percent of the government revenues and makes up for 67 percent of its exports. The Norwegian government has undertaken multiple steps to ensure an effectual management of the oil wealth, for the economy's prosperity.

Tax collected from the petroleum activities is a major source of Norway's revenue, and it totalled to about NOK 104 billion in 2015. The well-structured tax system is an essential aspect of the petroleum policy. The oil companies are subject to the ordinary company tax at the rate of 25% as well as an additional special tax, owing to the humongous returns, at the rate of 53%. Hence, the government receives in total 78 percent tax on the profits of the oil companies. The government has allowed new companies to enter into this arena by permitting them to carry forward the losses if they lack the sufficient revenues from existing fields to cover the costs of exploring new ones. The entire tax system is extremely neutral and has successfully maintained an equitable balance between encouraging companies to carry out profitable production and generating substantial revenues for the economy. Although the tax rate of 78 percent is rather high, the integrity and the transparency of the system have played a critical role in making Norway an attractive business destination.

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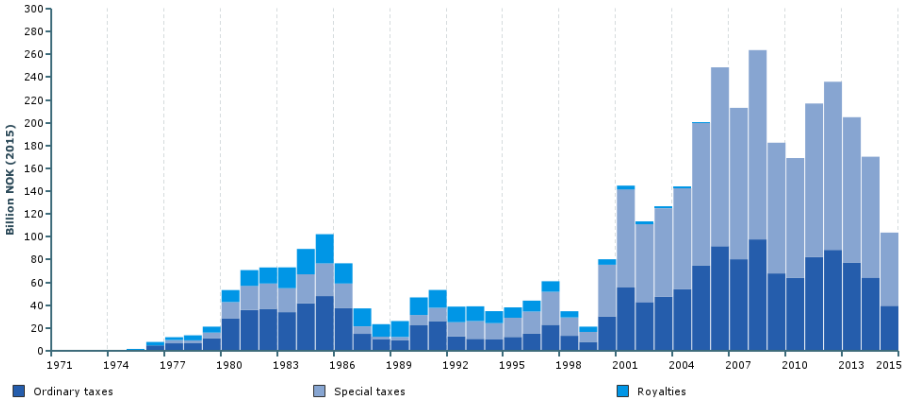

Chart 1: Breakup of Norway's Revenue for the period 1971-2015

The next important source of revenue is through the system of State's direct financial interest (SDFI), where the country has holdings in many oil and gas companies. It also has an ownership share in Statoil, thereby earning dividends from the company. The net cash flow from SDFI in 2015 was about NOK 92.7 billion.

A key element of Norway's fiscal policy is the Government Pension Fund Global. It was originally known as the Government Petroleum Fund, and was established in the year 1990 for the management of the petroleum revenues. It is a part of the ordinary government budget, and all the net revenues from the petroleum sector are transferred to this fund. In the case of a deficit, the amount is automatically deducted from the Pension Fund. The budgetary rule of the Norwegian fiscal policy states that during the course of a business cycle, government spending must include only the expected real return on the fund, which is about 4% per year. Utilizing the returns of the fund, and not the capital itself ensures that the fund will benefit even the stakeholders of the future. About 179.6 billion kroner was transferred to the fund in the year 2015.

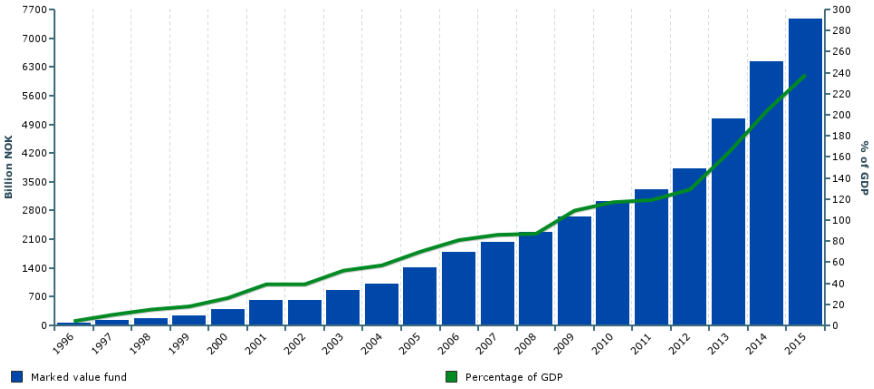

Chart 2: Government Petroleum fund as a percentage of Norway's GDP for the period 1996-2015

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Norway is by far the only OECD country to adopt the Extractive Industries Transparency Initiative. It is a global standard to promote public awareness and transparency about a country's management of its natural resources. A multi-stakeholder group, comprising the representatives of the companies in oil and mining business, of the government, and of the civil society, plays an active part in the implementation of the EITI standard in Norway.

Norway has an excellent quality and functioning of the institutions. It has a strong ministry of finance, a reliable and an independent judiciary, and a reputed civil service. The ministry of finance is responsible for the management of oil revenues, including the Pension fund. However, the investment decisions of the fund are dealt with by the Central bank and the Norges Bank Investment Manager. The Parliament regulates and oversees the overall framework and the budget and the petroleum sector as a whole is governed by the Ministry of petroleum and energy.

Norway has adopted a diversification policy to decrease the dependency on the petroleum industry. It has focused on developing the already flourishing petroleum sector as well as the remaining domestic industry.

Venezuela

Venezuela, unlike Norway and its elevated standards of institutional progress and governance, has been unsuccessful in getting rid of this economic plague. Rising levels of corruption and authoritarianism, distorted government policies, and uncontrolled political agenda have only fuelled the crisis. Venezuela has the largest oil reserves in the world (298 billion barrels, as of January 2015) yet, today, the country is one of the most depressed economies across the globe.

Venezuela's oil revenues account for roughly 95% of the export earnings, and the oil and gas sector accounts for about 25% of the GDP. Venezuela's oil reserves account for about 24.8% of OPEC's share.

Chart 3: Crude Oil Production in Venezuela for the period 2006-2015

The oil and gas regulation in Venezuela is reserved to the national government. Natural hydrocarbons reservoirs within the Venezuelan territory are public domain assets. The Ministry of Energy and Petroleum is responsible for the overall conduct of oil and gas activities. Petróleos de Venezuela (PDVSA) is the most supreme state-owned company in the sector. In addition to its subsidiaries, PDVSA is one of the largest vertically integrated oil companies in the world. Private sector companies are allowed to enter the oil and gas sector through joint venture companies (Mixed Companies), and the Venezuelan government must hold at least a 50% stake in them. The same restrictions are applicable to both private and

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foreign companies. According to the Income Tax Law, oil companies are subject to income tax at a flat rate of 50% on net income. They are also subject to a royalty at a rate of 30% based on the volume of the hydrocarbons extracted. A general consumption tax which lies between 30%-50% of the price is paid by the final consumer. A value Added Tax at the rate of 12% is levied on the sales in general and the sales of crude oil made to the PDVSA or its subsidiaries are taxed at 0% rate.

During the oil boom's in the 1970s and 2000s, the Venezuela Government spent generously on fruitless social welfare programs and disintegrated diversification projects. The prosperity during the boom made the government complacent and led the government in running up an extraordinary debt, the maintenance of which depended on the rising oil prices. Hence, the liabilities of the country were further advanced. There were myriad attempts at setting up developmental funds, however ever since inception, the funds' provisions were violated. To sum up, Venezuela lacked a reliable economic infrastructure that could help the economy to cope up during the times of turmoil (falling oil prices).

Venezuela has had numerous futile attempts in the past to stabilize fiscal expenditure. In the 1970s, a Venezuelan Investment Fund (FIV) was created. It was utilized to invest in the economy during the boom and support diversification. However, investments failed to serve the purpose of reducing volatility. Later in the 1990s, another stabilization fund FIEM (Investment Fund for Macroeconomic Stabilization) was created, but the functioning of the fund was adulterated to suit the need of administration. It served as a tool in the hands of the executives who got discretion over the disbursement of funds saved by the states. And therefore, FIEM too eventually turned into an unrewarding attempt. The National Development Fund (FONDEN), created in 2005, for the purpose of leveraging economic growth and sustainable development. FONDEN's resources primarily come from two sources. Firstly it receives all the oil revenue taxes paid by PDVSA and by private partners in joint ventures, and any additional resources demanded directly by the nation's president. Secondly, it receives funds from the Central bank. By the end of 2012, FONDEN had assets worth 30.2 billion dollars. It is to be noted that the transfer to the fund has been very erratic. For example, between the years 2005 and 2008, the amount that was transferred to it rose; however, the rise was minimal in spite of the fact that 2008 was, in particular, the year when oil prices soared high. Discretion over the PVDSA funds by the government bodies prevented an appropriate and sound transfer of funds.

Corruption in Venezuela has is omnipresent. In 2015, Venezuela tied for the country with the ninth highest perception of corruption in the world. Venezuela's tryst with corruption dates back to the mid-1970s, when the country experienced a sudden oil windfall, which tripled fiscal income. The officials in charge were exposed to extraordinary temptations and it was during this time, when corruption went out of control and corruption has remained high, ever since. There are three stages of corruption in the country – Grand Corruption at the top most policymaking level; Bureaucratic Corruption at the government bureaucracy level; and lastly Systemic Corruption at the interplay between the government and private players.

The management of the state-owned petroleum company PDVSA is acutely irregular. Increasing state control has led to a decline in the productivity of the company. PDVSA has not filed financial statements with the U.S. Securities and Exchange Commission since 2004 and there is no accurate record of the amount of income flowing into the national treasury. Moreover, there are multitude inconsistencies between its annual figures and those estimated by international agencies. For instance, the company claimed a production of about 3.2 million barrels per day, but OPEC placed it almost one million barrels per day less, at 2.3

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million barrels per day. Company officials are supposed to disclose their financial interests in oil projects, but that is hardly ever enforced.

Venezuela ranks poorly on measurements of corruption control and the rule of law, among the 58 Latin American and the Caribbean countries. With respect to its institutional and legal setting, it is at the 38th rank, reflecting the country's lack of independent licensing system and insufficient public disclosure system. The Venezuelan government does publish some information crucial to the key revenue sources; however, fiscal terms, licensing criteria etc. are not given. Environment Impact Assessments are published only after licenses have been granted. These indices validate the weakening of Venezuelan institutions' on the whole accountability and transparency.

A wide-ranging list of social and economic parameters is used to compare the overall progress of the two countries over a period of the last twenty-five years post the policy implications. These parameters highlight the economic health and also shed light on the social and political scenario in the backdrop of the abundance of oil reserves.

GDP Growth

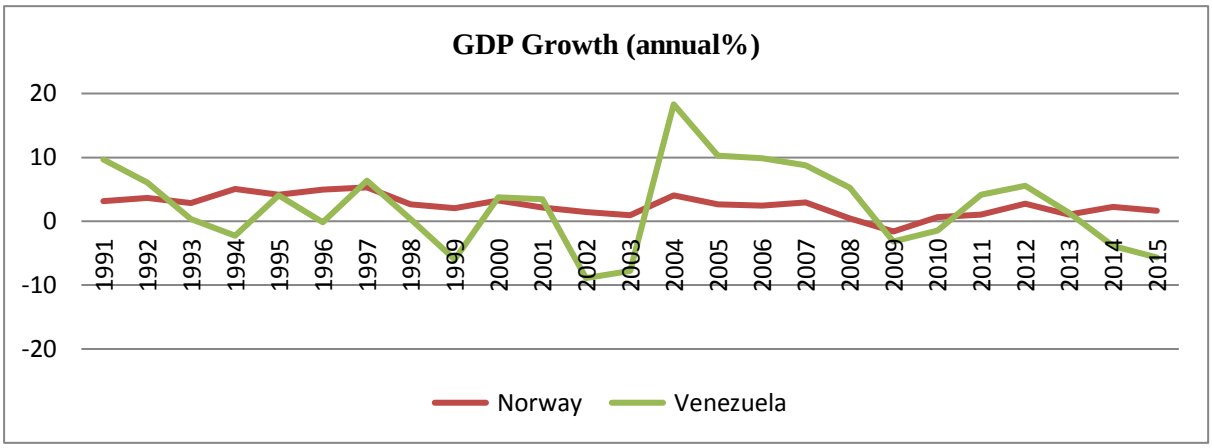

Chart 4: Comparative GDP growth rate of the two countries from period 1991 to 2015

The average annual GDP growth rate for Norway and Venezuela is 2.4 percent and 2.3 percent respectively. Despite similar average growth rate figures, Venezuela depicts a fluctuating growth graph due to the direct correlation with the fluctuations in the oil prices, while Norway denotes a stable one as it has an efficient regulatory framework and well-structured policy system and in place.

For Venezuela, besides the reduction in oil prices, the drastic fall in the GDP growth rate in 2002 and 2003 was aggravated by the military coup and the business strike. In 2004, it recovered from a two-months oil industry shut down and the economy grew and there was an increase in both consumption and investment.

In 2009, the growth rate of both Norway and Venezuela suffered due to the global financial crisis. Currently, Venezuela is facing negative growth due to the fall in the oil prices while Norway is maintaining its stability.

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

GDP per Capita (PPP)

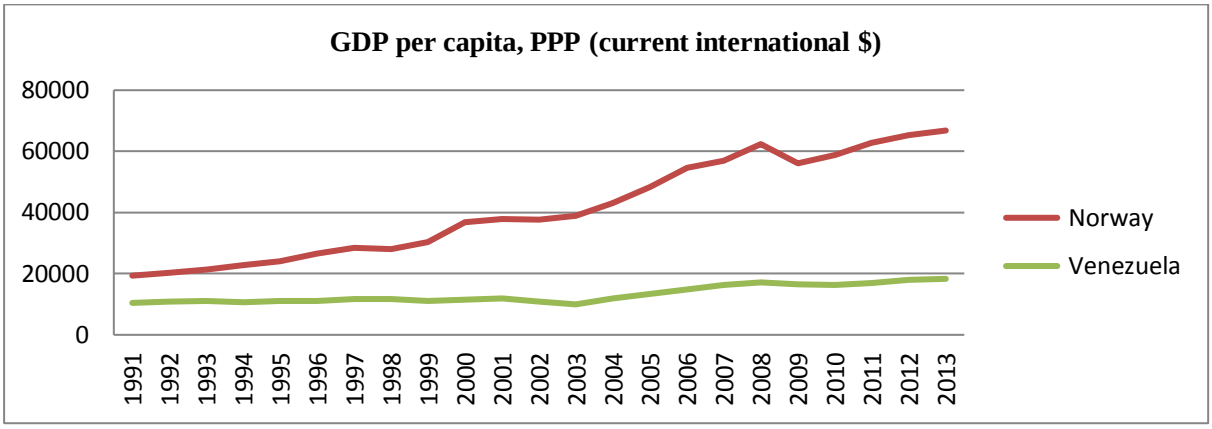

Chart 5: Comparative GDP per capita measured in PPP at Dollar rate of the two countries from period 1991 to 2013

To ensure uniformity in comparison, GDP per capita has been taken on the basis of the purchasing power parity at current international US Dollar. Norway has a lead of about $ 9007 over Venezuela from 1991 and the gap has increased gradually over the years and increased to a gargantuan figure of $ 48508 in 2013. Due to the fluctuating growth of GDP and higher growth rate of population Venezuela has maintained an almost constant GDP per capita with a slight increase 2003 onwards. On the contrary, Norway has been able to maintain a steady growth of GDP along with a constant increase in population due to which it has been able to achieve an increasing rate of GDP per capita.

Inflation

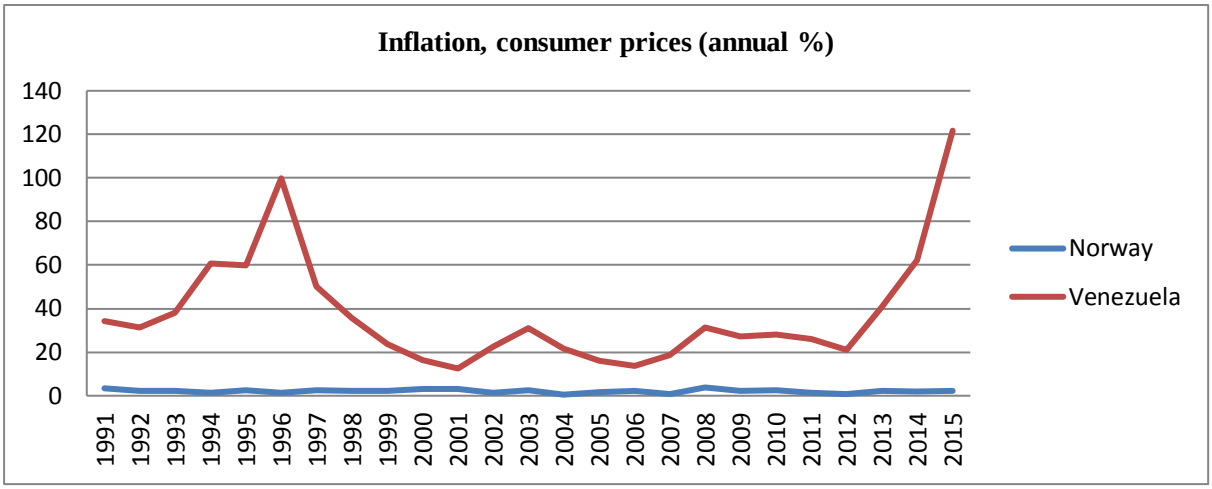

Chart 7: Comparative inflation rate of the two countries from period 1991 to 2015

The government policies of Venezuela are singularly dependent on the increase in oil revenues for growth. The economy is crippled due to inefficient utilization of its vast oil resources and overvaluation of its currency. Apart from oil, everything is cheaper to import than to manufacture domestically. Since it is mainly dependent on its oil reserves, it has to maintain its productivity by improving its competitiveness and to do this it has to establish partnerships with foreign countries which it is unable to do effectively due to a large number of barriers imposed by the government. Owing to the failed policies of the government and

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the presence of a corrupt bureaucratic system, the inflation rate has been sky-rocketing. Only in 2001, the inflation was at its lowest at 12.5 percent.

Norway has maintained its inflation rate in a tight range between 0.5 percent and 3.4 percent for a period of twenty five years owing to the following two reasons:

- The economic policies of Norway in 1970s and 1980s led to high and variable inflation as a result of which in December 1992 the fixed exchange rate system was abandoned and the monetary policies started focusing on inflation targeting.
- The government is not allowed to borrow money directly from the Norges Bank and thus this avoids the situation of deficit financing which is blamed for inflation.

Labour Force Participation

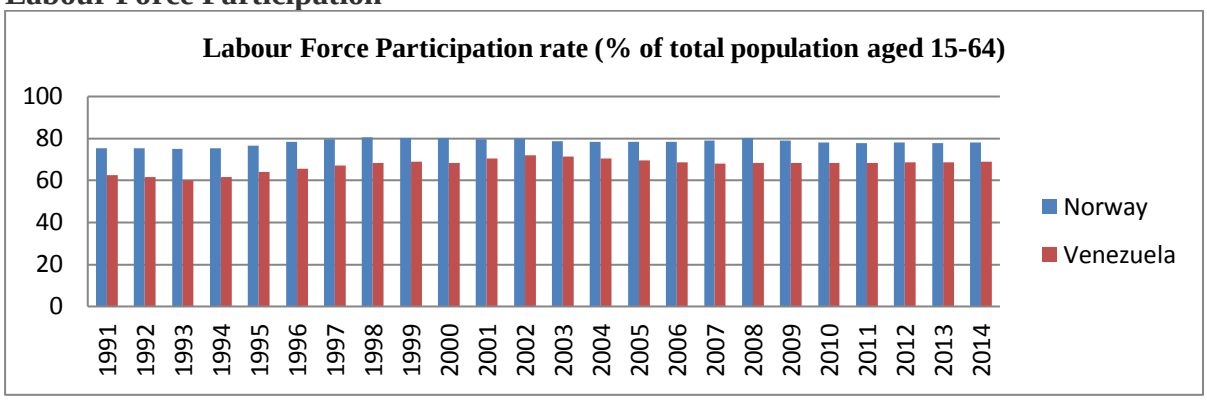
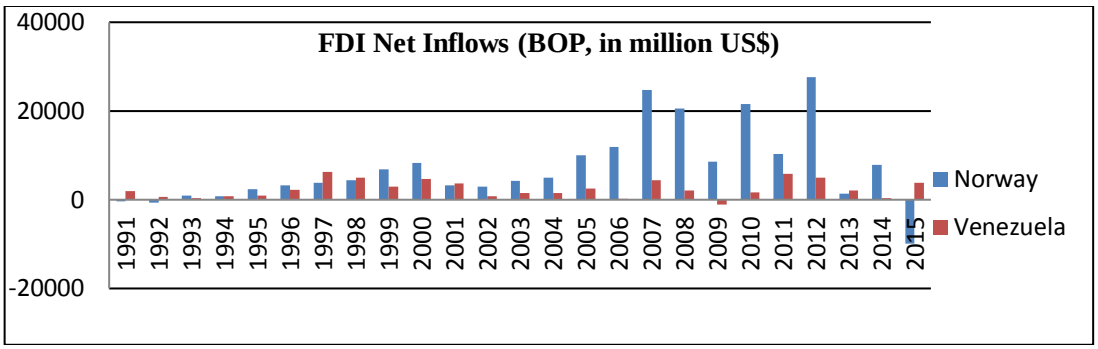


Chart 7: Comparative labour force participation rate expressed as a percentage of total working population of the two countries from period 1991 to 2014

Venezuela has maintained a labour force participation of a minimum 60.2 percent and as of 2014, it stands at 68.9 percent. World of Work Report 2013 states that the labour market situation and job quality had deteriorated between 2007 and 2011. Despite an above average labour force participation rate, the productivity of Venezuela has not been commensurate due to a weak institutional environment and labour market distortions.

Unlike Venezuela, Norway maintains a higher labour force participation rate, with an average of 78.2 percent over 24 years. In 2012, Norway had the highest rate among the OECD countries. However the real participation rate is not that high because of low contractual hours, high number of days lost to sickness leaves and high part-time rate.



Foreign Direct Investment

Chart 7: Comparative FDI Net inflows of the two countries from period 1991 to 2015

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In Norway, at the end of 1992, about one-third of foreign investment was in the oil and gas sector. The net inflows have been sporadic since the mid-1980s due to the impact of large individual operations and large loan repayments by a subsidiary to its foreign-owned parent company. This led to negative inflows in the year 1991.

In 2002, Venezuela faced the military coup and political instability which caused a significant drop in FDI in the oil industry, thereby leading to a reduction in net inflows from $ 3704 million in 2001 to $716 million in 2002. In 2006, as per the World Investment Report 2007, the negative inflows to the oil industry due to the financial transactions between Transnational Companies (TNCs) and the state-owned oil company PDVSA led to a sharp decline in FDI.

In 2009, both Norway and Venezuela faced a slump in FDI inflows; however, the latter was worse hit due to decline in oil prices and political instability.

A stable political environment and a well organised public sector make Norway an ideal hub for FDI. However, as its economy is largely dependent on the oil prices, due to the fall in the global oil prices in 2015, Norway witnessed disinvestments rather than the inflow of foreign investments. Despite large reserves of oil and a large domestic market, Venezuela ceases to be an attractive destination for foreign investments due to the uncertain business climate. A proof of the statement lies in the vast difference in the average figures of FDI inflows which are $7185.7 million for Norway and $2395.2 for Venezuela.

Corruption and Human Development

Parameters	Norway	Venezuela
Corruption Perception Index 2014	87(Rank 5)	17 (Rank 158)
Human Development Index 2014	0.944 (Rank 1)	0.762 (Rank 71)

Table 1: Comparison of levels of corruption and human development between the two countries

Venezuela is one of the most corrupt countries in Latin America, according to the 2014 report by Transparency International. Corruption in Venezuela has led to several cases of human right violation. Despite being an oil-rich country, Venezuela has lost a huge amount of public funds due to corruption which was accumulated for public welfare during the oil price boom periods.

On the other hand, another report by the same organisation states that Norway is one of the least corrupt countries in the world. However, Norway faces one setback which is limited enforcement of cracking down on bribing in Norwegian companies abroad.

The Human Development Index rankings are based on three basic areas — life expectancy, education and standard of living. The HDI value of Norway and Venezuela are 0.944 and 0.762 putting them in a very high human development category and a high human development category respectively. Norway was ranked number one in 2014 and has held that position since 2001, except f6r the years 2007 and 2008.

Between 1980 and 2014, Norway's life expectancy at birth increased by 6 years, mean years of schooling increased by 2.3 years, expected years of schooling increased by 4.4 years and GNI per capita increased by about 90.7 percent. For Venezuela, the life expectancy at birth increased by 6.1 years, mean years of schooling increased by 4.5 years, expected years

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of schooling increased by 4.2 years and the GNI per capita decreased by about 11.4 percent between 1980 and 2014.

5. CONCLUSION

An evaluation of the policies of both Norway and Venezuela analysed through economic and social indicators reveals the *causaproxima* to the stark economic differences between the two countries. Profligate utilisation and mismanagement of resources, widespread corruption, excessive state intervention and a ragbag of economic and political decisions made it inevitable for Venezuela to escape this curse. On the contrary, a host of unconventional policies, a structured management of oil wealth and systematized governance prevented Norway from falling into the resource curse trap. Norway's experience is a lesson for resource-rich countries, like Venezuela, that resource curse can be turned into a blessing with the implementation of right economic and political framework. In a state-led economy like Venezuela, it is vital to curb the illicit usage of revenues at the cost of degenerating the economy. The Venezuelan government must lay emphasis on a stable inflow of petroleum wealth through mechanisms like the well managed Norway's Pension Fund. Lastly, since oil reserves are public goods, the government must responsibly bear the responsibility of managing and utilizing its vast reserves through a scrupulous and transparent apparatus.

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