The Natural Resource Curse revisited: Theory and Evidence from India

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Abstract

In 2000, three of the largest states of India, with some of the largest endowments of natural resources in the country, were split to create three new states. We exploit the consequent dramatic change in the distribution of resources to examine the interplay between political change and the concentration of resources. We construct a theoretical framework to understand the potential outcomes in this setting and examine how secessions affect economic outcomes in the newly formed states. This framework is designed to account for two effects: the first, which is independent of the endowment of natural resources derives from the smaller size of each state post break up which makes administration easier; while the second derives from the increased concentration of natural resources in the breakaway states relative to the rump. We employ a sharp regression discontinuity design to estimate the causal effect of secession and concentrated resources on growth and inequality outcomes at the sub-regional level. We find that while the effect of secession is generally favourable, constituencies rich in resources see a relative worsening of outcomes in both activity and inequality. We attribute this local resource curse to political economy effects.

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