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Oil, Volatility and Institutions: Cross-Country Evidence from Major Oil Producers

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Abstract

This paper examines the long-run effects of oil revenue and its volatility on economic growth as well as the role of institutions in this relationship. We collect annual and monthly data on a sample of 17 major oil producers over the period 1961-2013, and use the standard panel autoregressive distributed lag (ARDL) approach as well as its cross-sectionally augmented version (CS-ARDL) for estimation. Therefore, in contrast to the earlier literature on the resource curse, we take into account all three key features of the panel: dynamics, heterogeneity and cross-sectional dependence. Our results suggest that (i) there is a significant negative effect of oil revenue volatility on output growth, (ii) higher growth rate of oil revenue significantly raises economic growth, and (iii) better fiscal policy (institutions) can offset some of the negative effects of oil revenue volatility. We therefore argue that volatility in oil revenues combined with poor governmental responses to this volatility drives the resource curse paradox, not the abundance of oil revenues as such.

Keywords Economic growth, natural resource curse, institutions, oil price volatility, oil income, macroeconomic policy

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