Oil & Development

The Global Record

By Terry Lynn Karl and Ian Gary

The gap between the promise of petroleum wealth and the perversity of its performance is enormous. Study after study demonstrates that, as a group, countries dependent on oil as their leading export have performed worse than other developing countries on a variety of economic indicators; they have performed worse than they should have given their revenue streams; and poverty within their borders has been exacerbated rather than alleviated over the past two decades.

The scramble for African oil has raised expectations that petroleum will boost the standard of living of exporting countries in the Gulf of Guinea. As Ed Royce, the Chairman of the Subcommittee on Africa of the U.S. House of Representatives says: "African energy is critical to African development. It provides a revenue stream…to break the cycle of poverty that plagues the continent." In West Africa the hopes of people watching new pipelines built through their communities or seeing the impressive installation of offshore platforms can be palpably felt. They believe that oil will bring jobs, food, schools, healthcare, agricultural support, and housing. "We were told by the company that we would have a new school, with books, and electricity and water," a Cameroon village chief reported. But these hopes are not likely to be realized if new African oil producers repeat the dismal performance of other petro-states.

This briefing paper examines the disturbing record of oil-exporting developing countries and their failure to reduce poverty and deliver on the promises of oil. It examines the "paradox of plenty" characterizing these countries, drawing on specific examples from Africa.

1. Oil-Rich, Dirt-Poor

The lived experience of oil-exporting countries over the past several decades tells a story which differs radically from the promise of petroleum. When taken as a group, all "rich" less developed countries dependent on oil exports have seen the living standards of their populations drop—and drop dramatically.

For most countries, including Algeria, Angola, Congo, Ecuador, Gabon, Iran, Iraq, Kuwait, Libya, Peru, Qatar, Saudi Arabia, and Trinidad Tobago, this development failure has been very severe, plunging real per capita incomes back to the levels of the 1970s and 1980s. For a few, most notably Nigeria and Venezuela, the failure to develop has been catastrophic; in these cases, real per capita income has plummeted to levels not seen before 1960. In Nigeria, which has received more than $340 billion in oil revenues, more than 70% of its population lives on less than a dollar a day, 43% lack sanitation and clean water, and infant mortality is among the highest in the world.

Even more worrisome, the gap between the expectations created by oil riches and the reality produced is a dangerous formula for disorder and war. Countries that depend upon oil exports, over time, are among the most economically troubled, the most authoritarian, and the most conflict-ridden states in the world today.

2. The "Resource Curse" or How Oil Dependence Produces Decline

Negative development outcomes associated with petroleum and other minerals are known as the "resource curse." Essentially, this refers to the inverse association between growth and natural resource abundance, especially minerals and oil. Countries that are resource poor (without petroleum) grew four times more rapidly than resource rich (with petroleum) countries between 1970-1993—despite the fact that they had half the savings. The greater the dependence on oil and mineral resources, the worse the growth performance, a finding that has been confirmed by economists in the World Bank and International Monetary Fund.

Under the current policy environment, here is how oil dependence hurts development:

Oil booms raise expectations and increase appetites for spending.

The promise of oil wealth dramatically expands the horizons of governments in oil-exporting countries. A boom mentality not only affects they way that governments behave, creating grandiose plans and ideas, but it also shapes how people respond. Work ethics are undermined, and productivity sinks.

Governments dramatically increase public spending based on unrealistic revenue projections.

In all OPEC countries, windfalls increased both public spending and the appetite for transfers by a factor that was more than proportionate to the size of the boom itself. This meant that spending quickly surpassed revenues. Nonetheless, different interests and groups continued to demand even large shares of national income when petrodollars were scarce.

Booms decrease the quality of public spending and encourage rent-seeking.

The concentration of fiscal resources from an oil boom fosters excessive and imprudent investment, and it also leads to the maldistribution of resources, a decline in productivity, and massive corruption. Grandiose "white elephant" projects, characterized by enormous corruption in the awarding of import quotas, industrial licenses, trade franchises, low-cost credits, and access to foreign exchange, become the normal way of doing business. Examples abound: a mountaintop resort in Venezuela, the largest airport in Saudi Arabia, a man-made river in Libya, the Trans-Railway in Gabon, and a new capital city, Abuja, in Nigeria. Oil-exporting countries are ranked among the lowest in Transparency International's World Corruption Index and are considered especially corrupt. In Gabon, a small elite connected to the government indulged in lavish spending and a cosmopolitan lifestyle. The country once garnered the title of "world's largest per capita importer of champagne."

Even in countries where a nominal amount of oil revenues are budgeted for health, education, and other important poverty reduction sectors, the quality of spending means that this spending often has little impact on improving indicators in these sectors. Gabon is a case in point. The country's relatively high income per capita masks large inequalities, and some social indicators are comparable to those of lower-income African countries." In 2001, the World Bank noted that "pockets of extreme poverty are growing in urban areas" and that more than half the population in the three main cities lack access to electricity or running water.

Declining productivity associated with the presence of "easy money" has hurt social services. A 1997 World Bank report noted that there "is a striking imbalance between the mediocre outcomes in health and education and the relatively high level of public spending for these sectors. The health sector presents a demographic and epidemiological profile typical of a poor country. Public health indicators are only average for Sub-Saharan Africa." Gabon spends more per pupil than most African countries, but this has not been reflected in outcomes. The World Bank notes, in the "absence of a sectoral strategy and efficient budget procedures, budget allocations are simply renewed each year without rigor and control."

The volatility of oil prices hinders growth, distribution and poverty alleviation.

The volatility of oil prices makes planning extremely difficult, and it hampers exchange rate unification and

Poverty amidst wealth. A shack made of scrap metal stands in the shadow of a Total petroleum terminal near Djeno, Congo-Brazzaville. Photo: Ian Gary, CRS

trade liberalization—all of which have a detrimental effect on growth. In OPEC, oil price volatility exerted a strong influence on government finances and patterns of national balance of payments, which subsequently meant that performance deviated from planned targets by as much as 30%. Furthermore, volatility has been shown by scholars to be bad for investment, income distribution, educational attainment, and poverty alleviation. And because oil price volatility has been getting worse, especially since the 1990s, even greater detrimental effects on economic performance can be expected.

Booms encourage the loss of fiscal control and inflation, further hampering growth, equity and the alleviation of poverty.

In the context of pressures to overspend, corruption, poor quality spending, and uncertain revenues, oil booms are accompanied by the loss of control over public spending. Because there is no transparency in the management of oil revenues, parallel budgets are created. As a result, price stability and budgetary discipline suffers. Thus, even as oil money is pouring in, government accounts are characterized by deficits and double-digit inflation. Almost all OPEC members incurred budgetary deficits year after year, with Algeria topping the list, followed by Iran, Indonesia, Nigeria, Saudi Arabia, Ecuador, Libya, and Qatar. Even the capital surplus countries of the Persian Gulf eventually began to run serious budget deficits.

Foreign debt grows faster in oil-exporting countries, mortgaging the future.

In most oil-exporting countries, external debt, which was negligible (except for Mexico) before the 1973 oil boom, has grown by leaps and bounds. As pressure on spending rises, governments borrow more and more, even mortgaging future oil payments to banks.

Astonishingly, pushed by rent-seeking and the loss of fiscal control, oil countries have borrowed faster and more than non-oil exporting less developed countries, despite benefiting from petrodollars. Rent-seeking is widespread behavior aimed at capturing petrodollars through unproductive and even corrupt means. This borrowing is both demand and supply driven. Governments seek to borrow to cover shortfalls in expected petroleum revenues, but bankers also especially favor lending to oil-exporters because their loans are backed by petroleum. Congo-Brazzaville, Angola, Nigeria, and Cameroon all have huge debts, while being enriched by oil wealth. Cameroon has even qualified for the World Bank's Highly Indebted Poor Country program for debt relief.

Non-oil productive activities, like manufacturing and agriculture, are adversely affected by the oil sector in a phenomenon called Dutch Disease.

The "Dutch Disease," brought about when oil windfalls push up the real exchange rate of a country's currency, tends to render most other exports noncompetitive. At the same time, persistent Dutch Disease provokes a rapid, even distorted growth of services, transportation, and construction, while simultaneously discouraging some industrialization and agriculture. Agricultural exports—a labor-intensive activity particularly important to the poor—in particular are adversely affected by economic dynamics set off by the exploitation of petroleum. The languishing of the agriculture and manufacturing sectors of oil countries not only makes them more dependent on petroleum, thereby exacerbating other problems of dependency, but it can also can lead to a permanent loss of competitiveness.

Gabon exhibits the classic symptoms of Dutch Disease. There is practically no local food production, which (contrary to that of neighboring Cameroon) has always been deficient, but has been virtually ended by oil dependence. Only about one percent of total land area is under cultivation so that, according to the Africa Research Bulletin, "Gabon depends entirely on imports for its food, consumer goods, and equipment […] the tomatoes are South African and the potatoes from France." Despite employing an estimated half of the workforce, the agricultural sector's contribution to GDP is only seven percent.

Meanwhile, the oil sector cannot make up the shortfall. Because oil is an enclave and highly capital-intensive activity, it provides little employment and relatively few linkages with the rest of the economy.

The $3.7 billion Chad-Cameroon oil and pipeline project—the largest private investment in Africa—produced several thousand temporary jobs during the construction phase. Now, during the production phase, only several hundred permanent jobs are left in Chad and Cameroon.

Petrodollars replace more stable and sustainable revenue streams, exacerbating the problems of development, transparency, and accountability.

Oil revenues over time decrease reliance on non-oil taxes, and they can actually replace previously existing taxation systems. This frees oil-exporting governments from the types of citizen demands for fiscal transparency and accountability that arise when people pay taxes directly to the government. Thus petrodollars actually sever the very link between people and their government that is the essence of popular control.

3. The Oil / Poverty / Conflict Syndrome

But the story gets worse. More than any other group of countries, oil and other mineral exporters demonstrate the perverse linkages between skewed economic performance, poverty, injustice, and conflict. Countries dependent on oil and other mineral wealth are far more likely to have civil wars than their resource-poor counterparts, and war disproportionately harms the poor.

The gap between expectations and the dismal economic performance of oil-exporting countries is politically explosive. Because oil governments funnel petrodollars to their own friends, family, military, and political supporters, social class, ethnic or religious groups, their populations see foreigners and favorites getting rich, but their own lot does not change. In the context of apparent oil riches, it may even get worse. Over time, this is not a formula for stability.

This pattern of spending has kept President El Hadj Omar Bongo (formerly Albert) in power in Gabon since 1968. Ruling the country as a one-party state since the early 1970s based on a policy of ethnic inclusion through his Parti Démocratique du Gabon (PDG), the decline in oil revenues forced him to resort to a measure of political opening in the 1990s, which, in turn, led to a reconfiguration of presidential rule. But there has not been a substantial re-framing of internal politics, which are still dominated by President Bongo.

The oil in Gabon, though, is starting to run out. Thus Gabon, once the regional role model of a successful "oil emirate" is now likely to become the poster child for the harsh reality of life after the oil boom. While high oil prices give the president some room to mask the looming economic and financial crisis due to falling oil production, economic problems are severe. Gabon has never been able to broaden its productive base, and no strategy for a post-oil economy has been implemented. A highly urbanized population used to consumer luxuries, imported food and profligate government spending will now have to make some harsh and unpopular economic adjustments, including restraining government spending. As those inside the patronage circle, as well as those left out from oil riches in the past understand that there will be no future benefits either, Gabon's much vaunted "stability" will be put to the test.

Militarizing Oil Countries

As petrodollars fail to keep pace with demands, oil-based governments often increasingly rely on repression to keep themselves in power. Not surprisingly, then, oil dependence is closely associated with militarization. As a group, oil exporters spend much more money and a greater percentage of their revenues on their military and security forces than non-mineral dependent countries.

The extent of militarization is stunning. In the decade from 1984-1994, for example, OPEC members' share of annual military expenditures as a percentage of total central government expenditures was three times as much as the developed countries, and two to ten times that of the non-oil developing countries. From the perspective of poverty alleviation, the sheer waste of this military spending is staggering.

Petrodollar Support for Authoritarian Rule

Not surprisingly, given this pattern of spending, oil rents have tended to impede democratization and have sustained a long line of authoritarian rulers—from the Shah of Iran to Nigeria's Abacha to the House of Saud to Saddam Hussein. These regimes prohibit the types of organizations that provide a voice for the poor, create an informed civil society, and permit their people to influence the management and allocation of oil wealth. Furthermore, dependence on oil tends to impede democratisation, and it may even erode democratic rule where it previously existed, as demonstrated by the dramatic case of Venezuela. This is especially unfortunate because democracy, when combined with merit-based civil services, reduces the corruption and mismanagement oftentimes associated with oil dependence.

Oil and Civil War

Fights over oil revenues become the reason for ratcheting up the level of pre-existing conflict in a society, and oil may even become the very rationale for starting wars. This is especially true as economies move into decline. Petroleum revenues are also a central mechanism for prolonging violent conflict, and only rarely a catalyst for resolution. Think, for example, of Sudan, Algeria, the Republic of Congo, Indonesia (Aceh), Nigeria, Iraq, Chechnya, and Yemen.

4. Poor Development Outcomes are Not Inevitable

Such grim development results are not inevitable. Resource booms can be detrimental, for sure, but they can also be beneficial. Norway (a relative newcomer on the oil scene) has used the benefits from North Sea petroleum to earn the highest place on the United Nations Development Program's list of best development performers. Thus, the country where people live best, according to a wide range of economic indicators, is an oil exporter. This means that the underlying development problems around petroleum are not inherent in the resource itself—oil is merely a thick, viscous black substance.

What matters for determining whether the poor will benefit over the long run from oil exploitation is how revenues are raised, what percentage remains inside the producing country, and how these revenues are utilized. Whether countries succeed in “sowing their petroleum,” that is, turning oil revenues into long-term benefits for their people, ultimately depends on the quality of public policy. Simply stated, given the right incentives for making good policy choices, petroleum revenues can be “black gold” rather than “the excrement of the devil,” as Juan Pablo Alfonzo, the founder of the Organization of Petroleum Exporting Countries, so poignantly warned.

5. Why Managing Petroleum is No Easy Task

Developing appropriate incentives is especially important because the successful management of any petroleum-based economy is particularly difficult. Countries dependent on oil exports are unusually susceptible to policy failure.

Concentration of Power and Resources

The reason lies in the interaction between economic and political power. Because the petroleum industry is more capital-intensive than any other economic activity and involves very extensive knowledge, skills and technology, only the biggest players, either multinationals or states, are able to exploit this resource. At the same time, because profit margins are so huge, the rents generated by oil generally overwhelm all other revenue sources. Thus, oil-led development has a strong tendency to concentrate both production and revenue patterns, and this occurs in countries where economic and political power often is already very concentrated. In effect, only large and powerful global and state actors can get into the oil game. Only those who control political power can grant the opportunity to make money from oil, and only those who receive this opportunity can provide the revenues to keep regimes in power. In Angola, for example, the country ranked the third worst out of 102 countries surveyed by Transparency International in 2002, the U.S. State Department has said:

> The country’s wealth continued to be concentrated in the hands of a small elite who often used government positions for massive personal enrichment, and corruption continued to be practiced at all levels...

A partnership of mutual interest (though often fraught with tensions) is created. This does not occur to the same extent in more diffuse wealth-generating activities based on, say, fertile soil or fisheries, where the barriers to entry are far lower, the actors more numerous, and the benefits more dispersed.

The Prevalence of Rent-Seeking

The result is what economists call a “vicious” development cycle based on rent seeking. In oil-exporting countries, all actors (whether public or private, domestic or foreign) have overwhelming incentives to seek links with the state in order to make money; governments, in turn, reward their supporters by funneling petrodollars, tariff protections, contracts, or subsidies their way. In the end, productive economic activity is actually penalized, growth is hindered, and economies become distorted. Political power can only be sustained only as long as oil revenues flow.

The Absence of Counter-Pressures

The difficulty of managing oil revenues well is compounded by several factors. Most important, most developing counties lack the type of political institutions necessary for counteracting rent seeking. Democratically accountable executives, efficient civil services and tax authorities, independent legal systems, active and informed civil societies, and open and transparent policymaking processes are simply not in place.

Furthermore, because profits are so huge in oil, even healthy pre-existing economic activities can be quickly disrupted and replaced by the growing reliance on petrodollars. It is easier to import than produce food if a government has the cash, and it is far simpler to buy technological know-how than develop it. Thus, the fiscal advantage of petroleum can actually serves as a handicap, hindering the development of other productive activities. In the end, rather than being able to use oil revenues to complement other economic activities, oil-exporters find that they are stuck in a permanent extractive phase—at least until their oil runs out.

Perverse Incentives from the International Policy Environment

Finally, the external policy environment rewards over-dependence on petroleum, overly centralized power, and even rent-seeking—merely by pursuing business as usual.

Oil companies, for example, at times make less than transparent deals with governments, and some pay secret bonuses that cannot be traced. This makes it difficult to assess their contracts, know what revenues actually accrue to governments from petroleum and judge whether the proportion accruing to countries is fair. It also makes it very difficult to hold governments accountable for their revenue management. Furthermore, as numerous studies have shown, powerful oil companies, whether foreign or domestic, come to play a disproportionate role in the decisionmaking of oil-exporting countries. This permits them to design laws and manipulate legal structures in their favor. It also means that they increasingly find themselves in politically-explosive situations. Witness, for example, the increasing number of lawsuits claiming that oil companies have supported human rights violations and environmental destruction (e.g., ChevronTexaco in Ecuador, Unocal in Burma, ExxonMobil in Indonesia, Occidental in Colombia, and Shell in Nigeria).

Home governments, acting in what they perceive as national security and economic interests, have formed strong alliances with authoritarian rulers who happen to sit atop oil deposits and have winked at their records of human rights violations. At the same time, they have failed to insist that multinational oil companies operate with the same standards abroad that they are held to at home.

Finally, International Financial Institutions (IFIs) also support oil's perverse development cycle by routinely encouraging development strategies based on the "comparative advantage" of petroleum, thereby helping to lock countries into a perverse pattern. At the same time, IFIs and private commercial banks support lending to deeply indebted oil-exporters, even when it is clear that debt only supports unproductive activities or papers over rent-seeking behaviors. Such practices prolong the ability of governments to mismanage their oil resources and help to defer critical but painful development decisions necessary to bring about change.

Where business lacks transparency, governments are accountable to none, economies are weak, administrative capacity lacking, and participation absent or wanting—yet investments and lending continue to pour in without restrictions—rent-seeking and corruption result. Over time, earnings are squandered, a precious asset is depleted, and widespread poverty remains.

The Deception of the Boom-Bust Cycle

Initially, oil development seems to work—at least for some time. Especially at the beginning, petroleum exploitation provides positive outcomes; per capita income may soar and financial accounts look startlingly favorable. Initially, the record shows petrodollar spending in most oil-exporters led to increased employment opportunities (especially in construction), generous pension plans for some, better nutrition, health, and infrastructure development. Telecommunications, paved roads, railways, and power-generating capacity increased considerably. In the few cases where oil-exporting countries have very small populations and very large oil reserves, (e.g., Brunei or the United Arab Emirates), these gains have been sustainable for some time.

But greater and greater rent-seeking undermines these positive outcomes. As economies grow more dependent on a depleting resource, as these resources are mismanaged, and as growth declines while demographic pressures grow, oil exporters move from exhilarating booms to painful busts. The volatility of oil prices—the rapid fluctuation from $8 to $35 per barrel and back, further undercuts efforts to turn oil wealth into other more permanent forms of sustainable development.

Boom-bust cycles affect even the world's richest oil exporters. Look at Saudi Arabia, where budgeting is murky, per capita defense spending is the highest in the world, and at least 10,000 princes from the House of Saud receive stipends running from $800 to $270,000 per month while the rest of the fast-growing population sees its opportunities decline. Even where proven reserves are the greatest in the world, productivity has taken a nose-dive and per capita income has plunged from $28,600 in 1981 to $6,800 in 2001.

6. The Bottom Line: The Urgent Need to Change the Policy Environment

The record of oil-exporting countries to date provides a powerful lesson for assessing the prospects for poverty alleviation in countries dependent on oil revenues. The message is clear: If oil is exploited as it has been in the past, that is, if revenues continue to lack transparency and accountability in their management, the results seem only too evident—and too grim.

If oil booms are to produce better results in Africa, the Caucasus, and other oil-dependent regions and countries, cycles of excess profiteering, rent seeking and boom-busts must be broken—or not permitted to start. For this to occur, powerful actors need to change some of their standard operating procedures. Had all the major players in the oil story behaved differently earlier—had international companies, their home governments, and banks insisted upon fair shares for poverty-stricken oil-exporting countries, transparent contracts, and transparent and fair revenue management, had governments and domestic private sectors been required to be more accountable to their publics, and had publics been more organized and informed—then the outcomes could be different. Oil revenues need to be closely monitored and fairly shared in order to turn them into positive development outcomes, hence the importance of campaigns to "Publish What You Pay" and to bring transparency and fairness to the industry. If the incentive structure currently surrounding huge oil rents is not changed, business as usual will continue. And the consequences for the poor will continue to be disastrous.

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Sources for More Information:

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