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FACTORS AND CHALLENGES IN DEVELOPING COUNTRIES UNDER THE RESOURCE CURSE

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ABSTRACT

Many oil-based countries failed to boost their economy development despite the long period of high oil prices going from 2002 to 2014. 12 years of inflated prices were marked by a more or less stagnated economy. While possessing large oil and shale gas resources for decades, many oil-based countries were and are still suffering from an economic collapse. This situation was long called the resource curse. The combination of oil price volatility, the pressure on agricultural and manufacturing sectors, the development of inequalities, and the disincentive effects of tax and weak institutions all result in a failure of policies and a growth collapse.

After July 2014, the global market changed after the rapid and most uncommon decrease in oil prices since the 1980s. The demand for oil crumpled around the world, but mainly in the US where oil production increased to the point of making it in competition with the biggest oil producers; both Saudi Arabia and Russia. The US changed its energy mix making it more dependable on domestic gas, and shale gas production more specifically. With all these changes, many governments are catching up and the experts have shifted their attention to the role of institutions. The institutional component is now a lead to government development success. Even though shale gas is being criticized for its environmental and technical issues, it raised the attention back to the “institution-economy connection”, which is claimed to work better than the “oil-economy development”. By analyzing the case studies of some oil-based countries, this paper concludes that the identification of a natural resource as a curse or a blessing will highly depend on the quality of institution itself.

Key words: Resource curse, OPEC countries, Oil management, Economic development, Role of institutions, Governance, Performance quality.

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1. INTRODUCTION

Since June 2014, oil markets have shown a significant fall in oil prices thus putting a lot of pressure on oil-dependent countries all over the world. Several reasons to this fall were
identified by experts; among the main causes listed are: an oversupply faced to a declining demand (mainly the US dependence on oil), the technological innovations that decreased the liquid fuel consumption in engines, the nuclear deal in Iran, the high US dollar value, the shale revolution in the United States and the geopolitical tensions in the Middle East. The shale revolution influenced the global energy markets to the point that many countries that are solely dependent on the oil resource started then to be alarmed about the danger of this crisis.

This paper highlights the strange situation in which many countries that are rich in natural resources are suffering from an economic vulnerability, internal conflicts and bad governance comparatively with the other countries lacking those same resources. This is called the resource curse, also called “the paradox of plenty” of oil-countries that have no clear vision of the post-oil.

Since oil prices began to fall in 2014, there was a rapid acceleration in the economic status along with deterioration in the government institutions in many oil states. Additionally, commodity prices have declined since 2011 and even more since the release of the April 2015 World Economic Outlook. Natural gas and coal prices declined, and the same effect is with agricultural commodities. Similarly, non-fuel commodity prices also weakened with metal prices. The whole situation put a lot of pressure on many governments and pushed them to revise their internal policies and improve their public administration. Many countries are currently seeking a change in the political and economic institution in order to avoid the resource curse, and achieve a better development on the long term.

With the current changes in the oil market, and the shale revolution in the US, many governments are catching up and the experts have shifted their attention to the role of institutions. The institutional component is now a lead to government development success. Even though shale gas is being criticized for its environmental and technical issues, it raised the attention back to the «institution-economy connection», which is claimed to work better than the «oil-economy development» (Grinets and Kaznacheev, 2014). While the resource curse theory presents all exporting countries as cursed to never progress economically; the performance of many resource economies, especially the US, gives evidence of a possible solution to overcome the so called curse.

2. FACTORS OF THE RESOURCE CURSE

The last 50 years show that the consequences of development, which is exclusively based on the export of petroleum, have tended to be negative. Among the apparent adverse effects are: an economic growth that is slower than expected, a weak economic diversification, bad indicators to the social well-being, corruption, high levels poverty and inequality, appalling environmental impacts at the local level, exceptionally poor governance and a rather high frequency of conflicts and wars. Countries exporting mining or petroleum products suffer from a surprisingly high level of poverty, inadequate health care, widespread malnutrition, a high infant mortality, low life expectancy and poor performance, especially compared to countries dependent on agricultural exports (Karl, 2007). Given the financial income of rich countries from natural resources, the poor situation is very astonishing. Because of the extreme volatility of oil markets, exporting countries are often the victims of brutal declines in per capita income and huge growth collapses. The statistics are startling, for example, it happened in Saudi Arabia, a country with crude oil reserves proven to be the largest in the world, per capita income decreased from 28,600 dollars in 1981 to 6,800 dollars in 2001. In Nigeria and Venezuela, real per capita income has plummeted to 1960 levels, while that of many other countries (Algeria, Angola, Congo, Ecuador, Gabon, Iran, Iraq, Kuwait, Libya, Qatar and Trinidad and Tobago) regained its level of the 1970s and early 1980s.
The surprisingly negative outcomes of countries dependent on both oil resources and mining are known as the "resource curse". Before studying what is the resource curse, however, it is useful to clarify what it is not. Resource curse does not mean that the abundance of natural resources is always or inevitably bad for economic growth or development, on the contrary, there are important historical success examples of a development based on natural resources, including the United States (who was the first world economy before extraction to become the world leader in manufacturing), Canada, Australia, Chile and Norway. However, the resource curse does not refer to the mere possession of petroleum or other minerals but rather it refers to countries that rely too heavily on oil revenues. This dependence is generally measured by the extent to which oil exports dominate total exports in general, from 60% to 95% of the total.

The resource curse does not mean that oil and mineral exporters would be in a better position if they had fewer natural resources. Oil is not more than a black and viscous substance that can bring either advantages or disadvantages: what counts really is not the nature of the resource itself but how is the oil wealth shared and used. The resource curse refers to the inverse relationship between high dependence vis-à-vis natural resources and economic growth. Several recent studies have shown that developing countries that are rich in resources have had results below those of developing countries without any natural resources. But the resources are not on an equal footing. Countries dependent on exports of natural resources extracted from a given geographical area, such as oil or minerals, are more strongly correlated with lower growth. In fact, rich countries with primarily oil and mining resources are among those with the lowest growth, even though they have high investment and import capacity.

The period of time in the 1980s is a key period as it also depicts how several countries who were oil exporters achieved positive development even after the decline in oil prices. A study of OPEC members countries, conducted between 1965 and 1998 showed that gross domestic product per capita had fallen by an average of 1.3% annually, while in developing countries without oil, it had increased on average by 2.2% during the same period (Gylfason, 2000). These studies show that countries dependent on oil export revenues not only they have lower results than those without natural resources countries, but also they have much lower incomes than they should get. The problem of the resource dependency has first been studied by Terry Lynn Karl who published a book in 1997 under the title: “The Paradox of Plenty: Oil Booms and Petro-States”. In her book, she described the institutional failures in many countries like Venezuela. From there, other economists analyzed the variables between: the institution, the resource curse and the economic development. Theories that try to justify the poor economic performances are very diverse and debatable, but there is a combination of factors resulting in the exporting oil countries to fall into the category of: political failure and growth collapse. The economists outlined the main characteristics that have a negative impact on growth in four main factors:

2.1. Factor number one: Oil price volatility

The international oil market is probably the most unstable in the world and politicians have difficulty managing sudden price fluctuations and the economic expansion that follow. The price volatility has a significant negative effect on budgetary discipline control of public finances, as well as public planning efforts. It is also accompanied by a negative impact on real investment, income distribution and poverty reduction. Latife Ghalayini (2011) suggested that usually oil price shocks will influence the economic performance in a number of ways which in itself influence the world economies especially when there is a limited oil purchase by oil importers. Indeed, the increase in oil price has an impact on both oil importers and oil
exporters. Of course, extractive industries have found ways around access problems by several strategic methods going through insurance, corporate planning, and cost reduction analysis. Price fluctuation is a business risk that can be managed effectively with good planning. Similarly, price volatility is also a risk on government finances that can be bypassed with strategic planning. Except that volatility is not considered as a risk but as a curse.

In Mexico, Agustin Carstens, an economist, has been using a hedging strategy that starts on December and ends in November the following year. Mexico is among the oil producers that succeeded in hedging export prices. Other producers failed at this strategy like Ecuador in 1993. For the coming year 2018, Mexico is planning to expand its oil hedge based on the expectation that oil prices will drop in the following year. The strategy proved to be successful to the country on several occasion since it started in 2000. In 2015, it earned a total of $6.4 Billion from oil hedges. Yet, the strategy can be of no use in the advent of oil price increase.

2.2. Factor number two: the "Dutch disease"/or Failure to compete:
Oil-dependent countries often suffer from what is called the "Dutch disease", a phenomenon in which the oil industry causes a rise in the exchange rate of the local currency, which automatically makes other exports very uncompetitive. Indeed, oil exports become the centre of exports and blocks other export sectors, including agriculture and manufacturing. This may raise the difficulty in diversifying the economy, and it can also inflict a permanent damage to the economy. In response, policymakers often adopt strict policies to support and protect the less competitive economic activities.

2.3. Factor number three: the lack of skills and performance quality
Another argument other than the recurring “curses” and “diseases,” is about governments own performance and skills. If an institution is able to manage the whole investment mechanism, then it can stabilize expenditures, and sterilize any excess revenue inflows of foreign currency. Since 2014, a high and first priority emerged as the importance of saving money and regulating fiscal spending to adverse any negative effects from oil price fluctuation. Various countries have already developed fiscal austerity policies, and created stabilization funds and other similar measures in order to reduce budget spending and curb the welfare provision. In that sense, the resource curse is perceived as an institutional rather than an economic problem.

Additionally, the oil-sector industry is an industry that requires skilled workers but usually the qualified labor are brought from abroad which deprives the exporting country from creating employment positions to their locals. Additionally, because the demand for petroleum education/training is low, this weakens further the exporting country.

In Algeria, Sonatrach, who is the leader in oil and gas production, transport and export in the country, has been quiet unstable due to the frequent change of the presidents in the last seven years, with an almost one new CEO every year. The company is currently controlled of the Energy Ministry which may lead to more instability in case of any political change. The successive changes in the company officials were described as the source of the poor performance and bad economical results, along with the total incompetence of these officials.

At the question of "how many barrels of oil are stolen every day?”, Garba Shehu, the president's assistant said: “The official position on the quantity of crude oil stolen per day in Nigeria is 250,000 barrels.” (Umejei, 2015).
Despite the fact that Nigeria is one of the big oil producers in the world with nearly 2.5 million barrels per day, this country has a flawed system because oil theft represents nearly 20%, thus producing nearly 500 000 barrels per day which at least 150,000 are refined clandestinely and derivatives sold in neighboring countries. 350,000 barrel per day for resale on the internationally by well-organized smuggling. Yet, there is no accurate data and no clear evidence about these thefts, so this makes scholars and government officials speculate and present different numbers.

In Norway, the success of a whole country relied on the skills and competences of one man, Farouk El-Kacim, called the mastermind of oil management structure (Benghida, 2017).

2.4. Factor number four: the problem of taxes, fiscal insecurity, and management of revenues

In many countries, oil projects are often large-scale projects that are owned by foreign companies. Therefore, production linkages with any other sectors of the economy of these countries are low. In general, revenues from oil exploitation go directly to the government, either as royalties or rents paid by foreign oil companies, or as taxes and profits earned by public enterprises. This arrangement is not conducive to the establishment of separate tax systems of oil, which further exacerbates the dependence on oil.

In Niger, the law on reform of the sector is expected and still awaited, the tax burden on low income and low-skilled workers is expected to decline from 94% to 86%, and the whole plan is until now discussed with no action in place.

Even inside many oil-based governments, there is oil theft and corruption. In Nigeria, this theft is gracefully called “nepotistic management” because all individuals appointed to manage the oil revenues are employed due to their familial ties. Nepotism is a word that refers to favoritism specifically granted to relatives. With the arrival of President Bouhari a new era of governance begins with the operation "clean hands", because after nearly half a century of oil exploitation 60% of the population is living below the poverty line.

3. DEVELOPING COUNTRIES OIL CHALLENGE

The decline in oil prices since June 2014 has forced oil producing countries to adapt to a new economic and social reality, plunging several states into deep economic and social crises linked to the depreciation of the exchange rate of their currency in dollar, their low tax reserves, and the declining fiscal dependence on oil revenues. Since the beginning of 2015, the oil economies have entered an era of drastic reduction in their spending and are trying to contain the social discontent linked to the reduction of subsidies and other benefits. The most spectacular crisis is affecting Venezuela. Despite the historic May 2016 agreement between member and non-member countries of the Organization of the Petroleum Exporting Countries (OPEC) to restrict crude oil production (which was extended from May 25, 2017 to March 2018), the outlook remains uncertain today, particularly in the face of the rapid development of American shale oil.

Beyond these immediate challenges to return to the path of economic growth, these states must also deal in the longer term with the "carbon risk", a risk that would constrain the production of hydrocarbons in the coming decades with the progressive deployment of energy transition policies. According to the International Energy Agency (IEA), the global oil demand is expected to decrease by some 20 million barrels per day (bpd) between 2017 and 2040; a decrease of about 20% from the current consumption. Most international oil companies (IPCs) are trying to adapt to control this carbon risk by diversifying their activities...
and strengthening the resilience of their assets; but the national oil companies (CPNs) of hydrocarbon-producing countries, in which the State holds more than 50% of the shares, do not seem to have taken the same initiative, even though they are being hit hard by the new reality of the oil market.

Mostly created during the nationalization movements of the 1970s, these companies aim to control the production and to manage the marketing of the oil and gas resources of the producing States. They have not been built following the same model whether in their relationship with the government, their international presence, their investment strategy or the degree of integration of their activities.

Some are assimilated to cash accumulation funds and do not have any real operational capacity. In countries like Venezuela, the state relies on its National Petroleum Corporation (NPC) to promote a political and social agenda, beyond economic goals. Other NPCs can take charge of developing national infrastructures or setting up social programs. Some companies are (or have been) run by the Oil Ministers, such as the National Iranian Oil Company (NIOC) until 2001, Sonatrach (2001-2003) and Petroleos de Venezuela SA (PDVSA) from 2004 onwards. CPN have activities that are usually the prerogatives of the State, like Sonangol, which rather acts as a regulator of the activities of the ICC in Angola and produces only a small part of the gas and oil extracted in the country. State-owned companies in emerging hydrocarbon-importing countries, such as China National Petroleum Corporation (CNPC), China National Offshore Oil Corporation (CNOOC) and China Petroleum and Chemical Corporation (Sinopec), occupy a special place in this landscape, their main objective being to guarantee access to resources with a large international deployment and foreign direct investments which have risen sharply since the 2000s, while ensuring strong domestic production where they are in a dominant position.

Algeria, Nigeria and Angola produced in 2009 respectively 1.1 million, 2 million and 1.8 million barrels per day on average. These state-owned companies face tough challenges in maintaining their hydrocarbon production and attracting foreign investment. They had to find new markets for their exports of light crude because of the shale oil boom in the United States and the collapse of US imports. Unlike the Consumer Price Index (CPI) whose sole purpose is maximizing profits, the strategy of an NPC is more complex because it must be in line with the country’s political priorities and generate financial revenues for supply the state coffers while producing positive externalities for citizens. These CPNs can also be used in the service of a clan, a party or even a family. This plurality of objectives tends to complicate the financial planning of the company and hampers the deployment of a long-term development strategy.

Faced with domestic energy consumption growing at a rate of 5% per year, the Algerian Sonatrach is indeed facing significant challenges. The new CEO of Sonatrach, Abdelmoumen Ould Kaddour stated in November 2017 that he was working on a new law for 2018 to attract private investors and his strategy is to be finalized by the end of 2017 (EPMAG, 2017). This reform could allow private companies to take the lead on certain deposits and restore the budget margins to Sonatrach.

In Algeria, Sonatrach alone produced 144 million tones and the rest was produced in association with the CPI. Nearly 98 million tons of oil equivalent were exported abroad, equivalent to $ 33.1 billion for the Algerian state (against $ 67 billion in 2014), or 41% of the country's budget.
To date, Sonatrach has produced only 106 million tons of oil in 2017. This amount has allowed the national oil group to earn more than $31 billion by the end of the year 2016. But this performance is described as insufficient until Sonatrach reaches the 190 million ton oil. However, despite its performance, the Algerian state-owned company faces many challenges and is currently strengthening its research and exploration work.

Most of NNPC's revenue comes from the five joint ventures that the Nigerian government has built with ENI, Total, ExxonMobil, Shell and ChevronTexaco. Apart from the joint venture with Shell in which NNPC owns 55% of the shares, all the others are controlled at 60% by the Nigerian national company. The big difference between production sharing contracts and joint ventures ones is that all partners finance investments in line with their level of commitment. There is no portage possible of the shares of the State. This is particularly problematic in Nigeria because NNPC very rarely manages to raise funds to meet successive fundraising calls. This very recurrent dysfunction delays considerably the investments.

The role of the main oil and gas companies is variable in each producing country. Although the strategy of the Algerian government since independence in 1962 has enabled Sonatrach to explore, produce, transport and create wealth by itself, it is running out of steam today after the oil price decline. While the role of NNPC is very different from that of Sonatrach because the organization’s goal is more about managing the profit generated by private companies. The 2014 crisis may lead to reforms, but this would require a strong political will and a long process of reforms to enhance all transparency and efficiency.

Chad is among the last oil countries in Africa. It started its oil production in 2003 when the pipeline going to the Atlantic Ocean was finished. According to the Oil and Gas Journal (2011), after nearly 30 years of exploration of its onshore sedimentary basin, Chad produces around 115,000 barrels per day in 2011, and sends its output through an underground pipeline of 1050 km passing through Cameroon to the port of Kribiau. But the crude oil production fell down a year later in 2012 to reach about 105,000 barrels per day and then in 2013, it has fallen again below 100,000 bpd and almost remained unchanged today in 2017. The establishment of the oil revenue law supposedly established the Control and Revenue Oversight Committee. This fixed income distribution in priority sectors. The Chadian government planned with its creditors to deposit all its revenues in a London Citibank account. The idea was meant to insure payment to all the creditors and get back the remaining revenues in the treasury account of the Chadian government. However, there were no records of how the oil revenues were monitored. Despite the aforementioned law, there's a total lack of transparency in revenue management, the World Bank left the project due to lack of government commitment to allocate the necessary income to the fight against poverty. Additionally, there are multiple military and ethnic tensions threaten the political balance of Chad, and multiple controversies on contracts between the state and Majors: on Taxation, the counting of production, modes of compensation of actors.

Equatorial Guinea has become a petro-state in 1996 and produced about 400,000 barrels per day with significant reserves of liquefied natural gas and world class methanol. This oil wealth to multiply by 10 the gross domestic product and 30 by the purchasing power of Equatorial Guinea. The country has impressive infrastructure for roads, health and social fields. The Equatorial Guinean economic model is no different from Chad and Nigeria; there is nepotism in revenue management, lack of economic diversification as there is no political strategy set for the post-oil era, and the fields of agriculture, fishing and fish farming, among others, are all completely neglected. Comparatively, the other sectors of the Norwegian
economy such as agriculture, fisheries, industry, services, are valued and they contribute significantly to the growth of the country.

Chad has a strong involvement of the ethnic group of President in Business. There is also a democratic vulnerability considering the president, aged 75 years old, and keeps being elected as a president since 1976. This regime can be compared to the Norwegian monarchy headed by a king; yet, the Norwegian model stresses the national unity and appoints members of the Government who must have the vote of confidence of the Norwegian parliament. In Chad, there are two positions of Vice President managed by either the Prime Minister or by the son of the Head of State. And the new law on hydrocarbons is rather "limited" because it results from donors' pressure on the regime than a real political commitment to good governance. It does not precisely define the powers of the regulatory authority on the control and distribution of oil revenues.

Except for the lack of democratic vitality Norwegian model resembles the Arab models (Saudi Arabia, Kuwait, Qatar, and Dubai). African models, apart from a few exceptions of social achievements and infrastructure (as Equatorial Guinea), are often examples of the oil curse.

4. CONCLUSIONS
When a government discovers oil reserves on its country's soil, it is normal that it starts to think strategically about how to manage the fiscal regime and implement a new system to earn high revenues. Every oil resourced country needs to have a policy that improves the gains. These gains are supposed to be shared with the society in many ways. However, the existence of a strategy or a policy does not mean this approach is forcibly successful because there are many factors that may influence the value of oil. The increase or decrease of oil prices, the fiscal system, the number of injection and production wells, the government corrupted system or unskilled professionals, and more importantly the government institutional system. Even a mineral-exporting country is capable to develop its economy if its institutional component is robust. Indeed, there is no economic development when boosted by a deficient institution, and vice versa. However, the high level of institutional development alone is not sufficient for a robust strategy.

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