Problems of the development of Civil Society in Oil-producing countries

a talk by

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June 2006

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Welcome

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A little about the Transatlantic Institute.

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My title is "Problems of the development of civil Society in Oil-producing countries".

In many countries, the presence of tradeable natural resources has historically been of great importance for the development paths that the economy and civil society have taken.

One historical example where the presence of an energy resource accelerated economic development is that of Britain during the Industrial Revolution in the 19th century. When international transport costs were relatively much higher than they are today, the availability of coal as a fuel within the British economy played an essential part in industrial development. Without it, Britain would have stayed an agricultural economy for much longer.

To someone studying this topic for the first time, it may be a surprise to learn about the numerous problems for economies and societies that can, through analysis, be traced back to the presence of abundant natural resources such as oil, natural gas, diamonds.

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The presence of natural resource riches can adversely impact society in the following ways:

impeding economic development (for example, slowing economic growth rates or even causing real-terms negative growth);
hindering education;
threatening social stability;
offering opportunities for government corruption.

Sound policies can mitigate these problems.

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Looking now at oil, which countries are we talking about?

Countries such as the USA (3rd biggest oil producer in the world), China (6th), Canada (8th) clearly have oil riches, but are all net importers of oil. Here are the top ten net exporters when ranked in order of the proportion of their production that they

export. [Table in slide]. Seven of these ten are OPEC members. Ignoring Norway, all of these countries have or have had issues of governance, corruption, human rights violations, social unrest, etc. which can be traced back to oil.

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(Impact on economic development)

The term "resource curse" was first used by Richard Auty in 1993 to describe how countries rich in natural resources were not able to use their wealth to boost their economies and how countries without large natural resource endowments had, on average, higher growth rates.

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Jeffrey Sachs and Andrew Warner noted in their paper Natural Resource Abundance and Economic Growth that economies with a high rate of natural resource exports to GDP in 1970 tended to experience slower growth in the following 20 years. (See graph -- Fig. 1)

Sachs's and Warner's observations remained valid even after controlling for many factors found to be important for economic growth. Quote: *It is possible that this negative association between natural resource intensity and growth is spurious, reflecting an association between resource wealth and something else that affects growth. Some common arguments are that resource-rich countries are more likely to adopt import- substituting, state-led development strategies, are less likely to accumulate capital at home because they can live off natural resource rents, are more prone to rent-seeking and to develop large inefficient bureaucracies, or are less likely to develop market supporting legal institutions. In addition, a long-standing view in the development literature is that countries that specialize in natural resource exports are more likely to suffer from unpredictable and disruptive shocks in global commodity prices.* These observations are true, but Sachs and Warner found, by eliminating factors known to be important for economic growth such as

- the degree of integration and openness that the country had with the world economy;
- savings rates in the country;
- the rule of law/ quality of bureaucracy;
- volatility in global commodity prices;
- and others

that these factors explained only a part of the negative relationship between resource intensity and growth. Sachs and Warner conjecture that the industrial structure is important for growth, and that there is a key distinction, for growth, between tradeable manufacturing and natural resource sectors. They state, however, that interventionist government policies to redress this balance by directly promoting the manufacturing sector, for example, by subsidies or tariff barriers, would entail welfare costs that could easily outweigh the benefits for economic growth. There are easier policy routes to higher economic growth, for example increasing openness to the world economy and removing trade barriers.

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Sachs and Warner look at the hypotheses that have been advanced to explain the connection between natural resource abundance and poor economic performance. The oldest is the simplest: easy riches lead to laziness and a lack of enterprise. More recently the theory of the "Dutch disease" was advanced. Manufacturing, it has been suggested, leads to a more complex division of labour than natural resource production, and therefore to a higher standard of living. But natural resource production promotes deindustrialization. An inflow of oil money often leads to currency appreciation. The Netherlands, in the 1970s, after the discovery of North Sea Oil, had a welfare state with unemployment and disability benefits set at a generous level which adversely affected workforce participation rates. Added to this, when the exchange rate increases as the result of a resource boom, it becomes more and more difficult to export, and domestic producers are less able to compete with a flood of imports. The resulting dependence on natural resource revenues leaves the economy vulnerable to natural resource price volatility. This phenomenon was named the "Dutch disease" by the Economist in 1977. (Naturally there are many reasons why a manufacturing sector could decline, this is only one of them.)

To address the threat posed by the Dutch Disease to the economy of a natural resource exporter, one possible policy instrument is that of the buffer fund. Not all the oil revenues are brought into the country when earned. Instead a sinking fund is established as a buffer. Such a fund is invested abroad, and the revenues repatriated slowly, thereby preserving macroeconomic stability and having regard to the welfare of future generations. Examples of such stabilization funds are the Government Pension Fund in Norway, and the State Oil Fund of Azerbaijan.

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The late Julian Simon put forward and defended the hypothesis, in his work *The Ultimate Resource*, of a secular real-terms decline in natural resource unit costs. The "ultimate resource" in the title of that work was human ingenuity and inventiveness which would find new and ever more efficient ways of prospecting, extraction, recycling, etc. leading to the decrease in unit costs. In the short term, of course, natural resource prices continue to exhibit volatility. But the long term trend had been noted empirically in the 1940s. The UN Commission on Latin America noted in 1950 the risks to Latin American states of over-reliance on a commodity, oil, whose price was in long term decline. The intellectual fashion at that date was that of demand management and economic planning. So the Commission promoted policies intended to help governments diversify their economies away from natural resource exports, which amounted in practice to defending domestic manufacturing industries behind tariff barriers and import quotas, rather than looking to export promotion. State-led industrialization as a growth strategy was a complete failure.

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(*The Logic of Collective Action*) Looking to political economy, the theory of interest groups, as explained by, for example, the late Mancur Olson, also offers perspectives on natural resources. Special interest groups can hinder innovation in society if they are powerful enough, for example if they can obtain government revenues from easily taxed natural resources. (Example: the Saudi royal family.) Innovation therefore tends

to be impeded in natural-resource rich societies. It has also been argued that natural resource abundance leads to greater corruption or inefficient bureaucracies, or that natural resource revenues distract governments from investing in those public goods that aid general economic growth, for example the rule of law, or public infrastructure. Instead, in the search for authority, governments adopt easy solutions, supplying natural resources at below market price to favoured client groups, establishing elaborate welfare systems, combined with a well-armed military.

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Nils Duquet ("*Angola's Rise to Regional Power*", St Antony's Int.Rev., May 2006) argues that oil exporting states are often able to rely on external income to sustain them rather than taxation, therefore insulating them from society, without the need for accountability to a wider population. Elite groups are corrupt, patronage networks enforce a lack of democratic accountability. Competition for the resources commanded by the state has been implicated in fuelling conflict. Paul Collier and Anke Hoeffler of the University of Oxford, formerly of the World Bank, in their series of papers entitled "*Greed and Grievance in Civil War*" have analysed risk factors for internal conflict and conclude that dependence on primary commodities is the most important risk factor predicting civil war. They state

Rebellion may be explained by atypically severe grievances, such as high inequality, a
lack of political rights, or ethnic and religious divisions in society. Alternatively, it might be explained by atypical opportunities for building a rebel organization. Opportunity may be determined by access to finance, such as the scope for extortion of natural resources, and for donations from a diaspora population. Opportunity may also depend upon factors such as geography: mountains and forests may be needed to incubate rebellion. We test these explanations and find that opportunity provides considerably more explanatory power than grievance. Economic viability appears to be the predominant systematic explanation of rebellion.

I link to Professor Collier's World Bank papers on my webpage at www.icoes.org.uk.

The petro-state has also been accused, by Thorvaldur Gylfason in his paper "Natural Resources Education and Economic Development" (2000), of crowding out human capital, in circumstances where there is no apparent immediate need for education. The resource-poor East Asian Tiger economies by contrast spent a vast amount on education, at least on technical/ vocational education, and this contributed to their economic success. On the other hand, it has been argued that the easily-obtainable rents from natural resource exploitation result in increased expenditure on education. The question is whether the people who have been through such an education system can participate in the workforce at a level befitting their educational attainment. Does the education system benefit the economy or does it merely function as an extension of the welfare system, helping to keep the unemployed/ unemployable (students) off the streets?

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Finally, in recent years, oil companies have come under pressure, or have willingly assumed the role, to contribute to civil society. Corporate Social Responsibility (CSR) programmes have been promoted by oil companies acting paternalistically in the developing world, with "community projects" providing facilities and welfare for their workers which the government has not provided. The subtext of CSR is that when first-world companies operate in the third world, first-world standards must be applied. Hence, complaints from activists and NGOs that, when wages are paid that reflect labour productivity in a particular third-world economy as a whole, rather than comparability with a similar job in a first-world setting, that this is "exploitation".

British oil companies seem more willing to accept CSR, with its supposed duties to a wide class of "stakeholders" (employees, customers, suppliers, wildlife, etc.), than American oil companies which are more likely to see their duty as owed strictly to stockholders. Some large companies (not necessarily in the oil sector) have been pushing for CSR standards, now usually regarded as "best practice" (for example, the OECD "Guidelines for Multinational Enterprises"), to be mandated by law. The proposed regulatory burden is more easily borne by large organisations which have a direct interest in erecting barriers to entry and protecting their own market dominance. John Browne of BP argued that: "*Only national governments individually and collectively can set the standards which ensure that those who behave in ethical and transparent ways are not undercut by those who don't"* (quoted by David Henderson: *Anti-Liberalism 2000, the Rise of New Millennium Collectivism*, IEA, p. 29). Henderson again quotes BP in *The Role of Business in the Modern World*, p. 140: BP's What we Stand For: "A good business should be both competitively successful and a force for good." This statement wrongly disconnects two closely-related concepts: a business's contribution to the public welfare and its profit-oriented activities, and thereby implies that profit-oriented activities on their own are not good, or not good enough to justify a business's existence.

Education to give a correct understanding of business's role in society is a public good! It is undersupplied by these large enterprises when speaking on their own behalf.

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Thank you.

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