

WORLD AFFAIRS

Hydrocarbon Wealth: The fool's gold

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II Year

The dynamics and analysis of oil curse

“Ten years from now, twenty years from now, you will see, oil will bring us ruin”, said the OPEC cofounder Juan Pablo Perez Alfonzo during the 1970s oil boom, when oil was first discovered in Venezuela and many other African and middle eastern nations. He called oil “the devil’s excrement” and his words were much censured then. But he was proved right: the euphoria of the oil boom was transient. It left behind in its wake a hangover whose effects still reverberate, particularly within the colossal expanse of the Middle Eastern and African nations that remain victims of the ‘oil curse’. These nations are bestowed with an abundance of hydrocarbon wealth (i.e. presence of huge reserves of oil and petroleum), which, in accordance with economic rationale, should have essentially lead to greater amount of prosperity, affluence and development. However, this is not the scene today, for many of these countries (i.e. Nigeria, Angola, Equatorial Guinea and Chad) remain plagued with civil war, social unrest, military coups, poverty, gross violations of human rights and instability, despite their hydrocarbon wealth. This is what is called the ‘paradox of plenty’,

or more particularly ‘the oil curse’, where possessing sufficient wealth in the form of hydrocarbons not only decreases the prospects of economic development but also increases the prospects of instability.

This paradox was first explained by Richard Auty who postulated the resource curse thesis in 1993, whereby he proposed that countries rich in natural resources had lower economic growth compared to their resource deprived counterparts. Examples include the Asian states of South Korea and Japan, which are the world’s most export oriented economies despite a lack of natural resources. A deeper analysis of the realm of economic and social institutions of oil rich nations show that there exists a set of well coordinated forces that work in synchrony with each other and gives rise to the paradox that turns this apparent blessing into a curse.

Dutch disease

Firstly, presence of excessive reserves of hydrocarbons and their exploitation leads to what is called the “Dutch disease” i.e. the slowing down of economic growth through a decline in local productive sectors. This

decline is a result of huge appreciation of the exchange rate brought about by surplus oil export foreign revenues, in the presence of floating exchange rate mechanism. The “Dutch disease” is named after the infamous Dutch experience in the 1950s when the discovery of oil reserves led to an unprecedented increase in foreign revenue along with bloated value of local currency. This had an adverse impact on the local manufacturing and service sector as manufactured goods and services became expensive and were unable to compete in the international market. Consequently, imports become cheaper and this further aggravated the plight of the local trade sector. Manufacturing units became sick and ran into losses that lead to a general increase in unemployment and a decrease in productivity of the economy as a whole.

Angola, which is Africa’s largest oil producer and has one of the richest hydrocarbon endowments in the region with oil revenue amounting to \$16.2 billion in 2009 has been experiencing Dutch disease since the 1970s. Due to abundant revenues received through export of oil and the consequent appreciation of the exchange rate, all other economic sectors with the exception of oil have stagnated or declined. Also, as a direct consequence of the Dutch disease, an appreciation in exchange rate gives an incentive to oil rich countries to accumulate debt and borrow irrationally because of cheaper interest payments on debt, despite the fact they receive huge revenue through the sale of crude oil. Thus, when the prices of oil plunge downward (like during the oil glut of 1980s), oil rich debt ridden nations default on their debts or are forced to pay penalties which draws them further into the debt spiral. In this regard, a special mention must be made of Nigeria, which is one of the many African oil rich nations that is a victim of the resource curse, since it first came into wealth

with the discovery of oil in the 1960s. It is observed that Nigeria had accumulated significant debt following the oil boom of the 1970s in order to finance its increasingly unproductive expenditure. There was growing indebtedness until the oil glut of 1980s led to a severe drop in global oil prices. Nigeria plunged further into debt and was forced to default. With a depreciation in exchange rate, the cost of living rose as most imported goods and services became expensive. There was a huge cut in the education and health sector expenditure along with sudden deterioration of social infrastructure.

High volatility of oil prices

Secondly, high volatility of the international prices of crude oil is another force that is responsible for perpetuating this anomaly or paradox by bringing about volatility in revenues for countries dependent essentially on oil for their inflows. Between 1960s and the first decade of the twenty first century, we had witnessed a series of oil shocks and oil gluts that had a debilitating impact on the global economy. The extreme volatility of oil prices lead to a severe distortion in the government planning and debt servicing process, and thus hampered economic growth. Moreover, the sudden cuts in revenue due to the oil glut lead to curtailment of important economic and social programmes and welfare schemes, causing widespread unemployment and discontent among citizens along with a deterioration of the law and order situation and political instability.

Lack of diversification of resources

Thirdly, the practice of non-diversification of resources into other important core sectors of the economy such as infrastructure, manufacturing etc. is responsible for further exacerbating the economic condition of oil rich nations. These sectors require huge

investments and have a large gestation period, but nevertheless are extremely vital to boost productivity, efficiency and employment in the economy. Oil rich countries prefer to depend on natural resources like crude oil, which generates quick revenue but plays havoc during price slumps. One example is Nigeria, which like many other African nations is the proverbial farmer that consumes all the seeds and has nothing to grow. The huge wealth amassed by it through oil in the 1970s was not effectively channelized into creating a good institutional base that is required for proper growth of the economy. Revenue collected was not spent on education, banking, infrastructure and other financial sectors as it yielded less returns over a long period of time. Thus, the economy plunged downwards and an increase in oil revenue did not translate much into economic growth or development or improvement in the standard of living.

Moreover, the natural resource sectors provide the highest salaries for both skilled and unskilled labour, which prevents them from working in other institutional (government as well as private) productive sectors important for economic growth. In addition to this, there is also a serious depletion of human capital because the natural sector in majority does not require much education for its workforce, which is in contrast to other resource deprived booming economies of South Korea, Taiwan, Singapore and Hong Kong i.e. "the Asian tigers", which essentially depend on skilled labour force for growth.

Ethnic and international conflicts and government corruption

Lastly, nations with abundance of natural resources find themselves in the midst of several ethnic conflicts and at times civil war and international aggression. This is a given fact, for tribes and communities are likely to

reach an impasse over control of resources and allocation of revenues as far as precious crude oil (i.e. black gold) is concerned since its distribution more or less tends to be inequitable. These events, along with the intrinsic underdeveloped stage the oil rich nations are in, further aggravates the problem because law and order is not strong enough to contain the uprisings, leading to political instability that hampers economic growth

In Nigeria, internal unrest and ethnic conflict has been in full swing since the 1960s, accompanied by a succession of military coups. The Niger delta (which is the principal oil producing region) has become a site of intense struggle between the local population and the government, where the locals have all taken up arms and formed a militant group called the Movement for the Emancipation of the Niger Delta (MEND). This group fights against the inequitable distribution of oil profits between foreign companies that reap the rewards of oil resources and the local population that continues to become poorer. The conflict in the Nigerian basin has taken a toll on oil production through excessive oil spills and a discontented labour force.

Angola is yet another oil rich country embroiled in civil unrest due to the separatist movement over Cabinda (a northern territory of Angola that accounts for two-thirds of the total oil production and contributes \$5 billion dollars to the gross exports earnings). The clash in the Cabinda region is a result of discontentment among the locals who believe that they have been deprived of their share of oil and are not getting enough through their endowments.

Also, there is always threat of international aggression by hegemonic nations who may want to establish control over the oil fields. In contemporary times, many view the US invasion of Iraq in 2003 as a means to establish control over the Caspian basin,

which connects many pipelines between Europe and central Asia. Moreover, there is tendency of oil rich nations to instigate international conflicts, which is popularly called 'petroaggression'. The Iraq-Iran war in 1980 and the Iraq-Kuwait war in 1990 give testimony to this fact.

There is also a problem of immense government corruption with little or no accountability that worsens economic conditions. The government of oil rich nations does not depend upon taxes for its revenue needs and mostly meets them through the export of crude oil and hence, remain, by and large, unaccountable. Through its control over crude oil, it serves to amass huge wealth, which it then uses to thwart and suppress those (i.e. the civil servants and voices of citizens) that challenge its power and position. According to a report published by Transparency International (2007), the OPEC oil rich nations rank very poorly in the corruption perception index.

Thus, by citing the examples of Angola and Nigeria, enough practical evidence has been given to support the oil curse thesis or the fact that abundance of resources has a negative impact on the democratic regimes and economic growth of an economy. However, in the recent years, we have seen countries like Norway successfully escape the clutches of resource curse. This is not because the theory of resource curse is not ubiquitous, but because Norway had the foresight to recycle its oil revenues into other sectors of the economy and indulge in rationale economic measures. It also had a good leadership together with a functioning democracy and a competent bureaucracy that further provided impetus to its economic growth. Thus, even though Norway might be an exception, the oil curse theory is necessarily a rule, particularly as far as poor, politically unstable, underdeveloped countries are concerned.

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BITCOINS

Shubhi Singh III Year

Invented in the wake of the global financial crisis by a mysterious computer guru using the pseudonym Satoshi Nakamoto, bitcoins are a form of cryptography-based e-money. They can be stored either virtually or on a user's hard drive, and offer a largely anonymous payment system.

Currencies serve multiple functions in society, but primarily they are used as a medium of exchange and as a store of value. In principle, bitcoins can fulfil both those roles for its growing community. As long as businesses choose to accept bitcoins in payment and there are exchanges to turn them into other currencies, they will survive as a medium of exchange. While