Resource curse

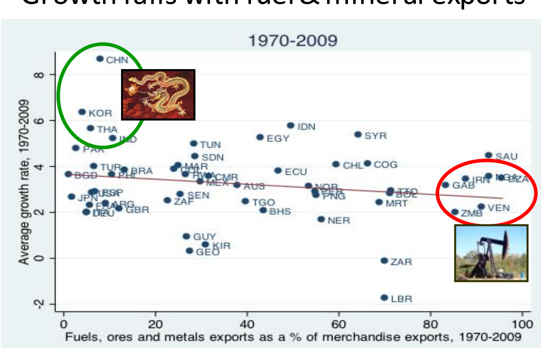
- Oil is a curse. Natural gas, copper, and diamonds are also bad for a country's health.
- Poor but resource-rich countries tend to be underdeveloped not despite their hydrocarbon and mineral riches but *because* of their resource wealth.
- This fact is hard to believe, and exceptions such as Norway and the United States are often used to argue that oil and prosperity can indeed go together.

- Many countries that are richly endowed with oil, minerals, or fertile land have failed to grow more rapidly than those without.

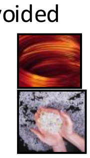
- Example:
- Some studies find a negative effect of oil *in particular*, on economic performance:
  - including Kaldor, Karl & Said (2007); Ross (2001); Sala-i-Martin & Subramanian (2003); and Smith (2004).
- Some oil producers in Africa & the Middle East have relatively little to show for their resources.

- Meanwhile, East Asian economies achieved western-level standards of living despite having virtually no exportable natural resources:
  - Japan, Singapore, Hong Kong, Korea & Taiwan,
    - rocky islands or peninsulas;
  - followed by China.

Growth falls with fuel & mineral exports



- Some developing countries have avoided the pitfalls of commodity wealth.
  - E.g., Chile (copper)
  - Botswana (diamonds)



- Some of their innovations are worth emulating.
- The 2nd half of the lecture will offer some policies & institutional innovations to avoid the curse:
- especially ways of managing price volatility.
  - Some lessons apply to commodity *importers* too.
  - Including lessons of policies to avoid.

6

Resource curse

- Juan Pablo Pérez Alfonzo, Venezuela's oil minister in the early 1960s and one of the founders of OPEC, was the first to call attention to the oil curse. Oil, he said, was not black gold; it was the devil's excrement. Since then, Pérez Alfonzo's insight has been rigorously tested -- and confirmed -- by a slew of economists and political scientists.

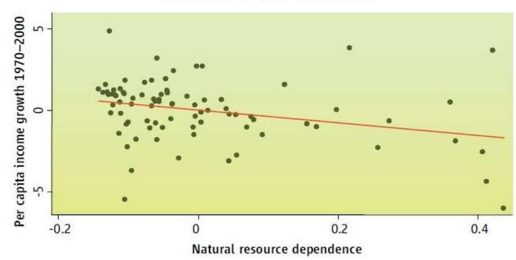
The Resource Curse

"Ten years from now, twenty years from now, you will see: oil will bring us ruin … Oil is the Devil's excrement."
Juan Pablo Pérez Alfonzo, an OPEC founder

Resource curse

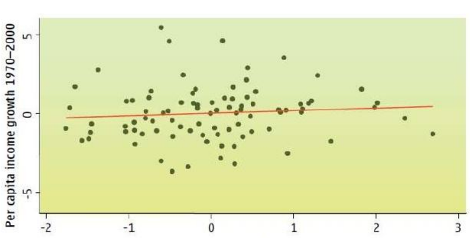
- In many of these countries, oil and natural gas account for more than 80 percent of government revenues, while these sectors typically employ less than 10 percent of the country's workforce. Inevitably, this leads to high income inequality.

Resource curse



Natural resource dependence, abundance, and economic growth. Regression fits of natural resources and economic growth 1970–2000. **(Top)** Natural resource dependence in 1970; **(bottom)** World Bank total natural wealth data (log values) measured in USD per capita in 1994.

Resource curse



Natural resource dependence, abundance, and economic growth. Regression fits of natural resources and economic growth 1970–2000. **(Top)** Natural resource dependence in 1970; **(bottom)** World Bank total natural wealth data (log values) measured in USD per capita in 1994.

Causes of the Resource Curse

- Reliance on Exports of Raw Resources
- The "Dutch Disease"
- Excessive Borrowing
- Revenue Volatility
- Conflict
- Corruption
- Resource Taxation and Democracy

This is the "resource curse"

- "Paradox of plenty" states with point resources (oil, diamonds) perform poorly & are subject to violence
- Large quantities of revenues make limited contribution to development
- Widespread poverty is often present
- External actors take an unhealthy interest in internal politics
- There is often little to show

Effects on the economy

- Resource in high demand
- Subject to price fluctuations
- Revenues cause currency exchange rate to rise
- Domestic inflation often takes hold
- Non-productive activities become more profitable
- Revenues are skimmed off and losing projects launched
- Population often realizes little or not benefits

Effects on politics & peace

- Revenues diverted to families, friends
- Corruption, bribery, etc. become commonplace
- Competition for control of resources develops
- Power struggles follow & can turn violent
- Groups seek to assert control over resources
- Revenues can fund internal warfare

Effects on society

- Elites with access to funds support their own interests
- Public services are not offered & decay
- People move to urban areas in search of work
- People living over resource are dispossessed
- Environmental damage undermines livelihoods
- General insecurity becomes pervasive

The Resource Curse

Possible Reasons:

1) Conflict
2) Responsible Government
3) Exchange Rate Appreciation (Dutch Disease)
4) Revenue Volatility
5) Excessive Debt
6) Corruption
7) Specialization
8) Reduced Education

The Resource Curse

Possible Reasons:

1) Conflict:
   a) Jurisdictional fights over the control of resources/revenues
   b) Armed conflict over resources
   c) Resource revenues may fund other conflicts (e.g., diamonds in Zaire)

The Resource Curse

2) Responsible Government

a) Resource taxed rather than citizens
→ less citizen pressure for effective gov't. and revenues less connected with general well-being

b) Those benefiting see an effective civil service as a threat → lobby to cut regulation/overview

Resource curse

- Most oil, gas, minerals exporting countries that do not have strong democratic institutions *before* they start exporting crude inevitably create an inhospitable environment for democracy.
- One promising new idea is to force multinational corporations to be more transparent about their contracts, investments, tax payments, and revenues in poor countries.

Resource curse

- Not all multinationals are accountable and willing to play by these rules, however, and it takes more than the threat of posting a report on the Internet to stop a deeply entrenched kleptocracy from stealing.

The Resource Curse

3) Appreciation of Exchange Rate

"Dutch Disease"

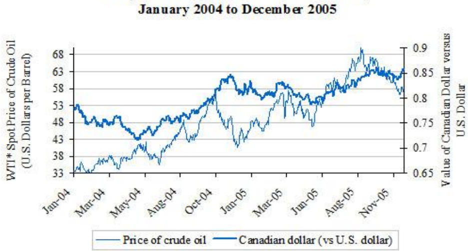
Refers to Netherlands in early 1960s

- Natural gas exports resulted in appreciation of exchange rate
- Manufacturing (and agriculture) harmed by high exchange rate
  - Their exports more expensive to others

The Resource Curse

Figure 3

Daily Price of Oil and the Canadian Dollar, January 2004 to December 2005



* West Texas Intermediate

Source: Bank of Canada and the Energy Information Administration.

The Resource Curse

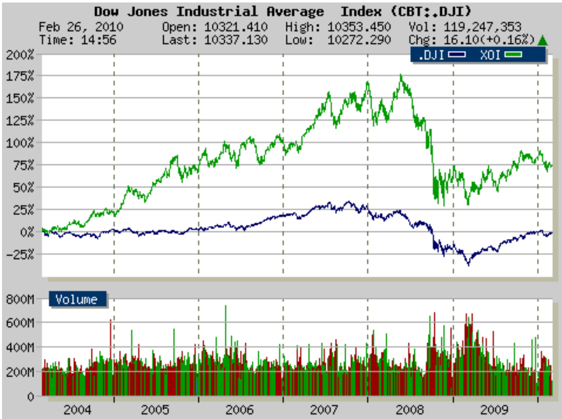
4) Revenue Volatility

Many natural resources prices are far more volatile than other prices

Example: Last six years

Dow Jones Industrial Index (blue)

Amex Oil Index (green)



The Resource Curse

4) Revenue Volatility cont'd

– Difficult to plan
– Difficult to maintain government programmes
– Not honouring contracts may discourage investment and encourage emigration

The Resource Curse

5) Excessive Debt

a) Prospect of future resource revenues encourages borrowing
   - Worsened by appreciation (inexpensive to borrow)
   - Resources act as collateral (others more willing to lend)

The Resource Curse

5) Excessive Debt

b) Less able to repay when prices fall or resource depleted
   - Worsened by currency depreciation
   - Worsened by penalty charges on late repayments

The Resource Curse

6) Corruption

Concentration of resource revenues may fuel political corruption

Usually do not need policies that encourage a well-functioning economy.

Instead may seek

- Regulation wavers(e.g., environmental, labour)
- Reduced royalty/taxation rates

The Resource Curse

6) Corruption (cont'd)

Whether lobbied for or not, there may be incentives to reduce democratic institutions or increase oppression of those who might oppose the resource development

The Resource Curse

7) Specialization

Lucrative resource sector out-competes other sectors

- lures most productive/best-educated workers
- High exchange rate discourages other exports (Dutch disease)

The Resource Curse

7) Specialization (cont'd)

Expect:

a) Increased specialization over time
b) Attempts at diversification often fail/very costly
c) Resource sector generally provides few jobs and have few (forward or backward) linkages to other areas of the economy (further concentrating power)

The Resource Curse

8) Reduced Education

Individuals and governments see a reduced need for education while incomes/revenues are high

Discourages innovation and further growth

Case Studies

– **Sub-Saharan Africa's Oil 2006**

– Angola	1,240 ('000 bpd)
– Chad	173
– Congo-Brazzaville	253
– Equatorial Guinea	355
– Gabon	234
– Nigeria	2,580
– Western Africa '000 bpd	4,950

– *Western Africa production* *$115 bn (total value)*
– *Total OECD aid flows* *$100-105 bn*
to *whole world* $bn (2006)

Sources: BP, OECD

Part 1

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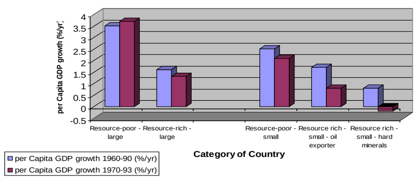
Sources: BP, OECD

Case of Nigeria

- Oil discovered in 1956; independence in 1960
- Broad religious & ethnic divisions across country
- Oil resources are all in the South, mostly Delta
- State control elsewhere
- Local economy under-mined by revenues
- $50-100 billion vanished
- Delta communities have struggled & some groups (e.g., MEND) attack & kidnap oil workers, etc.

The "Resource Curse": symptoms

- Slower economic growth
- Higher levels of conflict and repression
    - E.g. Collier: countries with 10% and 25% of GDP from resources have 11% and 29% risk of civil war in next 5 years respectively
- Higher corruption and institutional weakness



Example: Nigeria

Nigeria in 1970

GDP per cap (PPP):	$1113
Poverty rate	36%
Number of poor:	19m
Top 2% have same income as:	bottom 17%
Oil revenues since 1965 (1995 prices)	<$2bn

Nigeria in 2000

GDP per cap:	$1084
Poverty Rate:	70%
Number of poor:	90m
Top 2% have same income as:	bottom 55%
Oil revenues since 1965 (1995 prices)	$350bn

- Source: IMF WP/03/139, July 2003

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Part 2

- Are the transparency initiatives effective?

Case Studies:

- Elf Affair
    - Shows poorly understood nature of oil threat
- Angola's Russian debt
- Congo-Brazzaville

Case Study 1: "Elf Affair"

- Magistrates (Paris, Geneva) from 1994 uncovered Elf as giant, global offshore slush fund
    - For bribing African and other leaders (20-60c/barrel)
    - For financing French and European political parties
        - Originally right-wing; Mitterrand expanded it
    - For financing clandestine French foreign policy assignments around the world ("Strong arm of France")
        - E.g. Biafra, frigates to Taiwan, projects in Germany, Spain, Uzbekistan, Venezuela, etc.
    - For financing arms of the French intelligence services
    - Personal corruption

Russian debt 3: the Swiss Judge

- After $774m of $1.5bn paid, Swiss judge blocked the rest. Saw payments to personal accounts of Angolan officials, and to mysterious companies.
- Angolan government issued threats to release money.
- Damaged Angola's relations with IMF
- Swiss judge replaced, money released. Angola continued repayments.
- $1.5bn Angolan oil money disappeared
- ?Into private hands?

Case study 3: Congo Debts

- Elf lent $ to Congo Republic in the late 1970s (oil boom).
- When oil prices crashed, French interests provided new loans
  - To pay off old loans
  - To pay salaries
- Borrowing became an addiction.
  - France used it as as political lever over Congo's leaders
  - Elf and other companies leveraged the debt to obtain
    - » lucrative oil licences
    - » Cheap privatisation

Congo Republic's debts 2

– Congo's debts starved the government of money;
- Generating salary arrears
  which
- Created political instability
  which
- Helped push Congo towards civil wars

– Both sides in the civil wars used oil money to buy arms

Resource curse

The Democratic Republic of the Congo

- DR Congo is rich in precious minerals such as diamonds and gold - but its people have gained little from this wealth because of conflict and bad government.
- A new report by Human Rights Watch says gold deposits in the volatile north-east of the country have been the catalyst for much of the conflict in the area.

War in the DRC, 1998-present

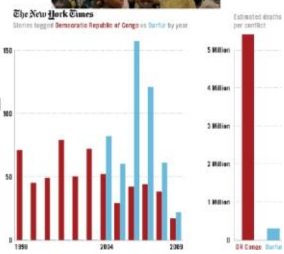
- An increasingly localized battle for control of natural resources
- Sexual violence used by all sides to displace, control, and traumatize
- The UN's largest peacekeeping operation (2000-present)
- Thousands continue to die

Reasons of Resource curse in DRC

- Natural resources finance armed groups committing sexual violence in eastern Congo
- Diamonds, tin, and 25% of world's tantalum minerals columbite-tantalite (coltan)
- Consumers in the United States unknowingly contribute to the conflict by purchasing these products
- The Congo's vast resources have never benefited its people

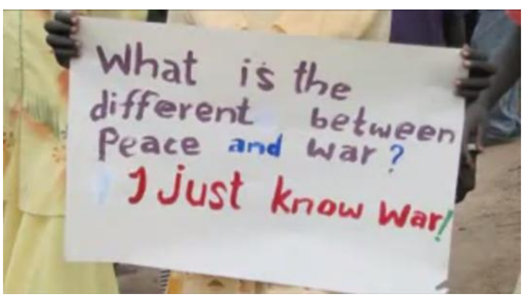
Despite 2003 ceasefire in DRC

- Systematic and widespread crimes against humanity continue
- 1,500 Congolese die daily from hunger, preventable disease, and other consequences of violence and displacement
- Half of deaths are children
- 1.3 million displaced



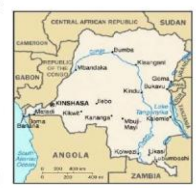
Humanitarian crisis

- More than 200,000 women and girls raped since the beginning of the conflict
- More than 33,000 children taken by armed groups
  - child soldiers
  - sex slaves
- Sexual violence continues at horrific rates



Humanitarian crisis

- Eastern Congo is the most dangerous place in the world for women and girls
- Rape on a scale seen nowhere else in the world
- Sexual violence to subjugate and humiliate populations they seek to control
- Unparalleled physical as well as emotional trauma



Humanitarian crisis

- Poverty forces many children to work in Mongbwalu's mines
- Before returning to the bottom of a 15-metre hole which he has dug by hand, James tells me that last month he found 10g of gold worth $130

Violence against women: the numbers

- Approximately 3,500 reported incidents of rape in North and South Kivu in the first six months of 2008
- 50% of survivors were under the age of 18
- Doctors Without Borders says 75 percent of all rape cases it deals with worldwide are in eastern Congo

Violence against women: root causes

- The weak state
- A culture of impunity
- Economic interests & natural resource exploitation

The ten reasons include the following -

1. Predatory security forces
2. Lawless militias
3. A culture of impunity
4. The resource curse
5. Poverty
6. A collapsed health care system
7. Internal displacement
8. A failing education system
9. Gender inequality and cultural barriers
10. INACTION

Ravage of resource curse

- Many women wait weeks for surgery to repair injuries from rape and torture. *Women waiting for fistulae and vaginal reconstruction surgery at Panzi Hospital, Bukavu.*

- Photo: Paula Allen/V -Day

Course still follow up

- Since August 2008, fighting has intensified between the Congolese army and rebels loyal to a renegade general named Laurent Nkunda (arrested Jan. 2009)
- 250,000 people displaced by recent fighting
- Sexual violence against women and girls and forced recruitment of men and boys remain daily threats

Part 3

- Key Questions
  - Would Elf affair have been possible with PWYP or Gabon/Congo in EITI?
  - Would Angola-Russia debt deal have been prevented with Angola EITI/PWYP?
  - Would EITI have prevented Congo's debt problems?

How money flows from the oil barrel - 1

Money is divided three ways:

1. Cost base (e.g. cost of oil rigs, helicopters)
2. To company shareholders
3. To host governments e.g. Angola, Nigeria
   - Royalties
   - Tax on company profits
   - Government share of oil
   - Other: signature bonuses, production bonuses, licence fees, income taxes, etc.

EITI/PWYP **DO** capture each item

PSCs: How money flows to oil countries - 2

- EITI/PWYP do NOT usually examine
  - The components *inside* the cost base - notably:
    - » **Commissions/bribes** e.g. via Fiba bank
    - » Mispricing etc.
  - Oil company **external investments** e.g. CPIH
  - **Oil-backed loans** e.g. to Abalone, Congo's debts
  - Government **expenditure**
  - "Missing oil" e.g. "bunkering" (Nigeria), mis-stated oil volumes

NB These are some of the most important flows, from a governance point of view

The Elf System (1)

- Elf Gabon central
- Gabon's Omar Bongo protected by hundreds of French troops.
- Bongo was no puppet
- French mercenaries operated out of Libreville.
  - E.g. support for Biafra rebels
- Freemasonry and secret societies link French and African politics
- African leaders only saw parts of the system, not the whole.
  - E.g. financing for Savimbi and dos Santos
- Other oil countries e.g. Congo as appendages

The Elf System (2)

- E.g. Fiba Bank (owned by Elf/Bongo family/Banque Indosuez/private) linked to offshore centres
  - Set up in 1975 - the oil boom
  - HQ in Paris, subsidiaries in Libreville, Congo-Brazzaville
    - BNA account, other African politicians and families
  - "If you do not understand Fiba you do not understand the Elf system."
  - Smaller amounts: sacks of cash (handed out in the Fiba car park) to French, Gabonese politicians, journalists, etc.
  - Larger amounts: links with Switzerland, Luxembourg, Monaco, Gibraltar, Liechtenstein, USA, etc.
    - BEAC: "Fiba-Congo never subjected to controls by parent"
    - $ Through many banks - Citibank, HSBC, CIBC, etc.

The Elf system (3)

- Le Floch: "Commissions" came out in part from cost base of industry.
- Summary: this looks like Al-Yamamah and US-Saudi relationship.
  - Difference: French magistrates broke in; US and UK law enforcement hasn't.
  - Extremely dangerous

Case Study 2: Angola's Russian debt Part 1

- Angola was a Soviet client in the Cold War
- 1995: Angola owed Russia around $6bn
- 1996: Russia agreed to a debt deal
  - Cut to $5 billion
  - Forgive 70%, leaving $1.5bn
  - Cut $1.5bn into 31 promissory notes
    - Each worth $48m
    - To be repaid in six-monthly instalments from 2001-2016

So far, so good….

Russian debt 2: Gaydamak and Falcone

- Arcadi Gaydamak and Pierre Falcone
  - Previously involved in financing and procuring $500m in arms for Angolan government in 1993-4 war
  - Falcone imprisoned; Gaydamak subject of international arrest warrant
  - Gaydamak arranged the debt deal, helped by Falcone
  - They became private intermediaries in the debt deal by obtaining the promissory notes for their private company, Abalone.
  - Sonangol paid $774m in to Abalone, which redeemed promissory notes to Angola
  - Through UBS Bank and trader Glencore.

What should do international community?

1. Peacemaking.
2. Protection.
3. Punishment .
4. Prevention.

The Resource Curse

What can be done?

I) Reduce appreciation of currency

Do not bring revenues into country (i.e., put revenues in a fund that is invested abroad)

- gives a more stable income stream
- provides an asset for future generations

The Resource Curse

What can be done? (cont'd)

II) Increase domestic savings

- run large government surpluses
- tax breaks for long-term saving
- reduce consumption borrowing

The Resource Curse

What can be done? (cont'd)

III) Heavy taxation/royalties on industry...try to avoid booms

- the resource will still be there if not extracted now

The Resource Curse

What can be done? (cont'd)

IV) Invest in education and infrastructure to increase competitiveness of other sectors

The Resource Curse

What can be done? (cont'd)

V) Increase anticorruption efforts

- Tighten rules on lobbying
- Improve rule of law
- Improve monitoring of human rights

The Resource Curse

What can be done? (cont'd)

V) Increase anticorruption efforts

- Further embed democratic procedures and institutions
- Increase monitoring of all levels of the government, civil service (including police and army) and judiciary

The Resource Curse

What can be done? (cont'd)

V) Increase anticorruption efforts
- Better define property rights of all those in resource extraction area (often indigenous peoples)

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