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BI-WEEKLY OIL REPORT

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The evil oil.

This has nothing to do with US President Bush's "axis of evil", but it is rather meant to describe the paradox of the hardships that the people of oil producing countries are facing. In a period that people are trying to analyze the events in Iraq and identify the reasons that brought us to this situation, we could not ignore at least two reports that discussed the issues that all oil-producing countries are facing. IMF's "Managing Oil Wealth" article and Christian-Aid's characteristic "The Oil Curse" report came out almost at the same time and their conclusions agree with those of previous researchers:

Possessing oil causes more pain than gain for a country!

The paradox has been researched before, but recent events have made analysts comments sound more interesting. The main conclusion that could be drawn is that the discovery of oil in a country will definitely cause a negative shock to the country's economy. Oil income creates a wealth shock in the society and leads to a crowding out effect on other economic activities. Increased consumption leads to higher prices, while strong exchange rates hamper exports, creating a cocktail that leads to diminished output. The "illness" was identified in the 60's and was called the "Dutch Disease", as it hurt Holland when it discovered natural gas. Norway went through similar painful conditions when it discovered oil in the North Sea, suffering contraction in manufacturing and high inflation during the 70's. The effects however of the "oil curse" were rather muted when compared to other oil producing countries and it is obvious that both countries have managed to recover.

On the contrary if one takes a look at Latin America, Africa or even the Middle East the effects are much more evident and despite some limited efforts countries seem unable to solve the problems they are facing. Venezuela had the highest per capita income in Latin America during the early 60's and now it is below Brazil, Mexico, Chile and Uruguay and its political situation is very unstable. Saudi Arabia's per capita income is below that of Puerto Rico and Slovenia. In Nigeria the percentage of people earning less than $1 per day (absolute poverty level) has risen from 27% in 1980 to 66% today.

Christian-Aid compared the growth between 6 oil-producing developing countries and 6 similar-sized developing countries without oil, covering a wide geographical range.

	Oil-Producers	Non-Oil Producers
	Angola	Bangladesh
	Iraq	Bolivia
	Kazakhstan	Cambodia
	Nigeria	Ethiopia
	Sudan	Peru
	Venezuela	Tanzania
Average GDP Growth (1960-today)	**+1.7%**	**+4%**

The clear difference between growth rates becomes even more impressive if one also considers that in this case oil-producers have lower literacy and life expectancy rates than the resource poor countries.

Analyses connect the exacerbated effect of the oil curse on developing countries on the lack of institutions to manage the wealth inflow and the lack of mature and stable democratic governments in order to build consensus, proceed to long term planning and distribute the additional wealth evenly among their societies. It is considered a given that different interest groups will want to arbitrarily divert oil income from the rest of the society and, unless these groups are contained and central planning is implemented, it is very unlikely that the country as a whole will benefit from the possession of oil. If government fails to control interest groups the results will be detrimental. The immediate results are extensive corruption, unstable and / or dictatorial governments and increased poverty for the majorities.

Even in ideal political conditions, however, it is hard to manage oil wealth. The greater the dependence on oil revenues, the greater the sensitivity a country has in price volatility. The continuous increase in volatility has led to frequently occurring boom-bust conditions that weaken stable institutions and make countries very vulnerable to corruption. The conclusions of most analysts converge to the need for oil-producing countries to diversify their economies and proceed to long term planning that will mitigate the effects of price volatility.

The above brief analysis can easily make clear how difficult the task of rebuilding Iraq will be. Even if one has the best of intentions for the Iraqi people, the task they are undertaking is not that of rebuilding an infrastructure, but rather that of rebuilding a society. This is a time consuming and painful process that is usually achieved through internal procedures and is not dictated by external forces. It is therefore likely that for the Iraqi people hardships and frustration will not be over soon.

Another issue that one should look into deeper is that even though analyses describe in detail why people in such countries are frustrated, it is considered that their reactions, if any, will be contained within their country. This underlying assumption, collapsed after September 11th, 2001 and it became even clearer after the recent terrorist attacks in Saudi Arabia and Morocco and the widespread fear that such events could spread in any part of the world. To put it in other words the “oil curse” could affect not only the ones that possess it, but those who use it as well.

It is wrong to state that oil breeds terrorism, but poverty and frustration provide fertile ground for preachers of extremism. One therefore cannot afford the consequences of a model that leads whole societies to poverty and destruction, not only because of ethics, but also because of the spill-over effects we just mentioned. And while we would consider it extremely hard to impose government systems on societies, another option would be to try removing the curse from them. Not by taking over their oil, but by diversifying our own energy needs, reducing petroleum demand and thus the world’s dependency on oil.

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