The Oil Curse: How Petroleum Wealth Shapes the Development of Nations

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Michael Ross talks to Viv Davies about his recent book 'The Oil Curse: How Petroleum Wealth Shapes the Development of Nations'. They discuss the irony of how those countries with the greatest social and economic deficits are also the most vulnerable to the oil curse and as a result grow less quickly than might be expected given their wealth. The video interview and original transcript originally appeared on the VoxEU.org website here.

Viv Davies: Hello and welcome to Vox Talks. I'm Viv Davies from the Centre for Economic Policy Research. It's the 20th of March, 2012, and I'm at the London School of Economics, talking to Michael Ross, Professor of Political Science at the University of California, Los Angeles, about his recent book on "The Oil Curse: How Petroleum Wealth Shapes the Development of Nations." We discuss the analytical basis for this study and how a country's mineral wealth is not necessarily the blessing it might seem.

Professor Ross describes how the irony of oil wealth is that those countries with the greatest social and economic deficits are often the most vulnerable to the curse.

He also points out the fact that countries that are rich in petroleum have less democracy, less economic stability and more frequent civil wars. The question Ross tries to answer in the book is how oil can be turned from a curse into a blessing.

Michael Ross: There's been an explosion of research on this issue in the last 12 years or so and even though there are some popular accounts I didn't feel like there's one book that is kind of relatively comprehensive and that tries to identify the most robust findings in the literature. I realized that, like any issue, what exactly is going on in the oil rich countries is kind of a moving target but I thought it would be useful to have an effort to craft a comprehensive analysis that could hopefully then be used for further research. It also seemed to me useful from a policy perspective because we're at a point when growing demand for oil is leading to the lateral spread of production to new low income countries.

For the last 20 years or so, the number of oil producing countries in the world has been more or less flat. It's begun to rise now and it's projected to rise by maybe one or two dozen states in the next five years or ten years. And so, if there's a time to figure out interventions that can mitigate the resource curse, the oil curse, this is that time.

Viv: OK. So, could you perhaps give us a sense of the sort of data and type of analysis that was involved in the study?

Michael: The study is based on a quantitative analysis of observational data from all countries, basically 170 countries, from 1960 to 2006. So, I've tried to kind of take in the full scope of the last 50 years. I think one of the innovations in the project is to use what I think is a better measure of a country's oil wealth. Early studies would measure it by looking at a country's dependence on oil exports but I and others have noticed that sometimes being dependent on oil exports can itself be a sign of some underlying proceeding ailment. And so it's not a very good way to measure a country's geological wealth, which I think is closer to the core of the idea that some sort of exogenous environmental factor has an effect on a country's political and economic development.

So I look at oil income per capita and try to follow the effects, not just in the whole 50 year period as looking as a unit, but also to look at how the effects have changed over time. I think one of the innovations in the book, or one of the messages in the book, is that the oil curse really only emerged in the 1970s. Before the 1970s you didn't have the kinds of problems that we see today. And when we go back and look, of course, at what happened in that period, it's not surprising because that was the period of nationalization.

Not that things were all rosy during the era when the petroleum world was controlled by the seven sisters, the big oil companies. But the fact that you had major international oil companies scooping up the rents and repatriating them in oil-producing companies meant that the governments were more or less insulated from, unaffected by, the geological riches underneath their soil.

After nationalization, however, the full consequences of their oil wealth became apparent as the governments collected much, much greater windfalls and the market much less stable.

Viv: And they channeled a lot of their spending through these nationalized industries.

Michael: That's right. If national oil companies were simply national oil companies, I think we'd see many fewer problems, but they became vehicles for all kinds of projects, often patronage, corruption, transfers to the military. And politicians, incumbent leaders, realized that they can use their control over national oil companies to circumvent other political checks and balances. That's made them, I think, a central, core part of the problem of the oil curse.

Viv: So it's an issue of governance in many ways?

Michael: I think it mostly comes down to governance. The initial idea of a resource curse, which was sort of popularized in 1995 in this famous paper by Jeffrey Sachs and Andrew Warner, was that there was an economic curse. That if you had more resource wealth, you would grow more slowly. I think that's not really right, and in the book I show that that may have been true during the specific period looked at by Sachs and Warner, but that's partly because this was the period of falling commodity prices, so commodity-dependent countries naturally saw their incomes fall as well.

If you expand and look before and after, you find that the oil producing companies have done really not much better, not much worse than other countries. The mystery is not why they've grown slowly, the mystery is why they've grown at a relatively normal rate when they should be growing faster given the access to capital that they have.

Viv: So I guess that's one of the key questions of your book. It's not that oil producing countries are growing less slowly relative to other countries, but they're not growing as quickly as you might have expected, given their wealth.

Michael: That's right. I call it disappointingly normal growth. Now, some dimensions of this are relatively well understood, and many people have written quite insightfully about it. I focus on two dimensions that I think are not well explored. One is why it is that governments have such a hard time stabilizing the revenue streams and why oil stabilization funds typically don't work. The second is how economic growth is undermined by unusually high fertility rates, that is, high population growth, in the oil-producing countries. If, instead of looking at income per capita, you look at total income, the oil-producing states have done quite well. The problem is that their populations are growing faster than populations in the rest of the world.

And I have developed an argument in the book about why this is so, suggesting that oil wealth tends to crowd women out of the labor force. It creates jobs for men but not women, under certain conditions, and the result is with fewer women in the labor force, you have higher fertility rates. Higher fertility rates mean less growth per capita over the long run.

Viv: Is this what you mean when you state in the book that "the irony of oil wealth is that those countries with the greatest social and economic deficits are also the most vulnerable to the oil curse"?

Michael: Yes. I think many studies show, and mine confirms this, that the poorer you are ex ante when you discover oil, the more difficult it's going to be to manage and invest those resources well. There's a whole variety of reasons, some political, some fairly straightforward and technical. The absorptive capacity of the domestic economy may be limited, and the revenues may grow much, much faster than the economy's ability to absorb reasonably efficient new investments. And even though, in theory, you could park the surplus in a stabilization fund, in fact, those funds just don't work very well, and usually the surplus disappears through inefficiencies or corruption.

As you get richer and richer and you tend to have better and more effective institutions and greater checks and balances ex ante, this becomes less of a problem. It's much easier to invest a lot of capital. Typically, oil wealth is a smaller fraction of your total economy, even if the number of barrels produced is quite large. And you have generally more effective institutions for dealing with some of the problems that arise from large windfalls.

Viv: So what is it about the nature of the problems associated with oil revenues that's different from those sort of problems that are associated, or as a result of, other natural resource curses?

Michael: The evidence seems to show that the curse is most strongly associated with petroleum and not with other kinds of hard rock minerals. Now, that's not a very precise evaluation, because we don't measure other kinds of mineral production as well as we measure oil production. And on top of that, oil is far and away the dominant mineral resource in international trade. Something like between 90 and 95 percent of all traded minerals are made up of petroleum and its by-products.

So, there aren't so many economies that are dominated by mineral production that is not oil production. So, we don't have as many observations, as many cases. And it could be a statistical fluke.

Having said all that, I would guess that oil is particularly problematic because the rents it tends to generate are huge. Because it is capital-intensive, typically more than extraction of other hard rock minerals. And very little of the rent is diffused through labor costs and spillovers to the regional economy.

Instead, the vast majority of the rents accrue to the government directly. And hence, the ultimate economic consequences for the economy depend heavily on the quality of the government and the government's ability to spend and manage this money.

Viv: So is the oil curse an inescapable fate or are there particular policy recommendations or conclusions that you make in the book which will help towards finding a solution for this issue?

Michael: I do argue there are quite a few policy interventions that could make a difference. Having said that, they're often based on...they're not based on the same kind of careful analysis, because we don't have that many examples of countries that have done well, even though they have considerable oil wealth. So, a lot of it is sort of theory and speculation. But having said that, I think there's quite a bit that can be done. Particularly, you can change what I think is the heart of the problem, that is the unusual qualities of oil revenues, their size and speed with which they accrue to the government. You can change the volatility, and I have some suggestions, some ideas about better ways to offset volatility than the standard stabilization funds.

And I think transparency plays a big role, a bigger role than I appreciated when I first began to do the analysis. And transparency is important also because it gives the oil importing countries a role.

And in fact, there's some important initiatives under way, both in Europe and in the US, to force companies, extractive industry companies, to disclose much more specifically the payments they make to governments in the territories they do business. And that would be an important step towards triggering greater accountability.

Viv: Well, it's a great book. It's a great read, very accessible. Michael Ross, thanks very much for taking the time to talk to us today.

Michael: Thanks very much. It's a pleasure.
