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Africa's Recent Oil Boom: Are the Same Mistakes Being Made Again?

Investigating the Effect of the Recent Surge in Oil Prices Upon the Prospects of Long Term Development in Sub-Saharan Africa

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RHDANT004

A minor dissertation submitted in partial fulfilment of the requirements

for the Degree of

Masters of International Relations

University Of Cape Town

Faculty of Humanities

Department of Political Studies

2009

This work has not been previously submitted in whole, or in part, for the award of any degree. It is my own work. Each significant contribution to, and quotation in, this dissertation from the work, or works, of other people has been attributed, and has been cited and referenced.

Signature

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05/08/2009

Acknowledgements

The successful completion of this work has been due to many friends, family and colleagues. First I would like to thank my faculty advisor Professor Robert Mattes. Through his timely guidance and enthusiasm for all things related to data analysis and empirical research, his advice was invaluable. I would also like to thank the Political Studies Faculty; it was often the case that I would roam the corridors of the department seeking out information and ideas. I was never disappointed.

A special thanks also has to be given to my partner, Astrid Ayele. Her calm response and rational outlook was the perfect tonic to moments of self doubt. Indeed it was her idea and encouragement that began the whole process of undertaking a Masters degree.

I must also thank many of my colleagues, who unknowingly, through long drawn-out political and economic discussions, gave me invaluable ideas and information, as well as many laughs.

Last and by no means least, I would like to thank my parents, who have given me such incredible support in every conceivable way. The undertaking of my Masters thesis would not have been possible without their encouragement.

Abstract

There has been as yet no empirical study that has undertaken to identify how Sub-Saharan African (SSA) states have allocated the wealth generated from the 21st century oil boom. The answer to this question may well determine whether Africa has any prospect of sustainable resource led development in the near future. This work is an empirical study into how oil states have allocated their wealth in the modern era, and whether there has been a divergence from the past. The main goal is to revise the common view (based as it is on the experiences of the 1970's and early 1980's), that increased levels of oil wealth serve only to undermine the prospect of long term economic growth within developing countries.

I argue that improvements in the political environment have increased the possibility that the 21st century price rise has been used more productively than was the case thirty years ago. Thus the focus of this paper is to identify how oil states have improved their use of oil wealth in the recent era, and the factors that have brought this about. To achieve this end, I have created a set of variables that identifies the amount of oil wealth that has accrued to African governments (during the 21st century price rise), and the areas in which these funds have been allocated. I have also measured levels of political and social freedom to determine whether the political environment is one that has improved from the previous price hike period.

My empirical findings display two clear results. Firstly, the political environment has improved significantly from the previous era, and secondly, the pattern of resource allocation has changed dramatically, to one that holds out a much greater prospect of positive long term economic growth. Based upon these results, it appears that SSA oil states have broken away from the negative effects associated with the resource curse and the previous oil bonanza.

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Acronyms

BP	British Petroleum
BPD	Barrels Per Day
EIA	Energy Information Administration
EIR	Extractive Industries Review
EITI	Extractive Industries Transparency Initiative
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GNI	Gross National Income
ICPC	Independent Corrupt Practices Commission
IDEA	International Institute for Democracy and Electoral Assistance
IFI	International Financial Institution
IMF	International Monetary Fund
MRSF	Mineral Reserve Stabilization Fund
NEEDS	National Economic Empowerment and Development Strategy
NGO	Non Governmental Organization
OAU	Organization of African Unity
OECD	Organisation for Economic Co-operation and Development
UN	United Nations
SPSS	Statistical Package for the Social Sciences
ZCC	Zero Corruption Coalition

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Chapter 1:

Introduction

The Problem:

While scholars have focused on the negative effects of oil booms on growth and development within Sub-Saharan Africa, there has been as yet, no study of whether the most recent period of inflated oil prices has followed the same negative pattern. The central problem which I wish to understand, is whether the 21st century oil boom holds out any prospect for greater development, or like the oil boom of the 1970's, will act as a constraint on growth. Are Sub-Saharan African oil states committing the same blunders (in terms of resource allocation) as they did in the 1970's and early 1980's, or has the new found oil wealth been allocated more productively?

Long suffering from economic stagnation, Africa has in recent years had a great opportunity to utilise its natural resource abundance and overcome years of underdevelopment. There are now a greater number of oil producing states than ever before, prices remained high for an extended period, and levels of export capacity continue to rise. I wish to examine the impact of the 21st century boom upon the prospects for development. The main focus of my thesis is to identify whether Africa's petro-states are making the same mistakes as their predecessors, or whether they are undertaking more positive steps in terms of building strong foundations for future economic development.

Significance of the Study:

The way that any state uses its wealth is important, but in the case of oil dependent states, and especially those in Africa, the allocation of resource revenue has an enormous bearing on political and economic development. Rapid increases in the price of oil have the potential to stimulate development, but if used unwisely they can have a disastrous impact upon long term patterns of

economic growth. Whether oil is a blessing or a curse depends on two important factors. First, what type of political regime exists within the state; and secondly how does that regime, and the government located within that regime, allocate its resource funds? Africa, for so long marginalised, underdeveloped and unable to break its colonial dependencies, has had the opportunity in recent years to break this cycle of negative growth by using its abundance of natural resources. Those same resources though have the potential to hinder development rather than encourage it. The question of whether Sub-Saharan Africa can utilise its oil wealth and avoid the pitfalls related to such a potent commodity, is one that has enormous repercussions across the continent. The answer to this question may well determine whether Africa has any prospect of positive change or whether it will languish again into a cycle of underdevelopment.

As yet no study has investigated the effect of the recent surge in oil prices upon the prospects of development. By identifying where states have allocated resource wealth during the recent price rise era, I hope to bring a fresh new perspective to the state of our knowledge, which is based upon events that took place over 30 years ago. Specifically I will search for signs that contemporary African states have developed improved strategies to use their oil wealth more productively, and thus overcome some of the most damaging effects of the 'resource curse'. Such evidence would breathe new life into a subject that has become focused solely upon the negative effects of oil wealth, and the inability of states to break free from the cycle of underdevelopment.

My Argument:

I argue in this paper that due to improvements in the domestic political environment, as well as improvements amongst the international community and within the oil industry itself, contemporary oil states have radically changed the way that they use their oil wealth. They have broken from the disastrous economic policies undertaken by their predecessors in the 1970's, and have undertaken a more responsible use of oil generated wealth; one that holds out the prospect of sustainable resource based development and economic growth.

Chapter 2

Literature Review

The existing literature on the subject of resource dependence, commodity booms and economic development focuses upon three key questions. First, scholars have tried to establish whether there exists a relationship between resource wealth and poor economic performance; here the general consensus is that there is indeed a negative relationship between the two. This broad finding has led scholars to ask two other questions; 'what causes this negative relationship?' and, 'what can be done to prevent this resource curse?'

The review of literature is broken down into those three areas of investigation in which past scholars have focused the most attention. The first analyses 'the effect' of the resource curse. The second analyses 'the cause' and finally I analyse those theories that explain ways in which the 'curse' can be avoided.

The Effect

The effect of natural resources upon growth and development

Existing empirical evidence conclusively shows that states whose economies rely on exporting natural resources exhibit some of the lowest levels of development and growth. To put it simply, economies with abundant natural resources have tended to grow less rapidly than natural-resource-scarce economies. The hypothesis then that there exists a negative relationship between resource dependence and poor growth has proven to be empirically robust.¹

¹ Sachs, Jeffrey and Warner, Andrew, *Natural Resource Abundance and Economic Growth*, Harvard Institute for International Development, Development Discussion Paper no 517a, October 1995. This observation from the authors is further supported by the following empirical studies: Sachs, Jeffrey and Andrew, Warner, 'The Big Push, Natural Resource Booms and Growth', *Journal of Development Economics*, Vol, 59, 1999, 43-76; and Berg, K. et al, *Trade and Development Strategies for the Poorest Countries: A preliminary Investigation*, (Institute if Development Studies Working Paper 12, December, 1994); and Auty, Richard M and Mikesell, Raymond F, *Sustainable Development in Mineral Economies*, (Clarendon Press, Oxford, 1998)' and Gelb, Alan H, *Oil Windfalls: Blessing or Curse?* (Oxford University Press, 1988); and Karl, Terry Lynne, *The Paradox of Plenty: Oil Booms and Petro-States*, (University of California Press, London, 1997).

There is also substantial empirical support for the assertion that commodity booms (like that of the oil windfalls of the 70's and early 80's) lead to declines in growth and development once the boom ended. The general consensus amongst scholars is that the impact of a rapid increase in the price of certain export commodities (like that of oil in the 1970's) has an extremely disruptive impact upon patterns of economic growth amongst developing countries. The 'boom' according to such writers as Gelb, only exaggerates economic and political problems that are inherent to oil producing states. 'The sudden inflow of resource wealth may give the immediate appearance of positive growth, but over the longer period its effects are clearly negative'.²

Amongst Africa's oil dependent states, the finding has even greater validity. Empirically, Sub-Saharan oil states have exhibited the worst records of growth relative to the levels of wealth they are able to accumulate through oil extraction. If resource abundance has a negative impact upon development, then it is oil more than any other commodity that has the most negative and destabilising effect upon economic growth amongst African states.³

Resource dependence also has a significant impact upon the political environment. A great deal of evidence strongly supports the hypothesis that resource dependent states (especially those reliant on oil) are more likely either to be authoritarian, or if they are a multi party system, have less of a chance of consolidating democracy and have a poor record of governance.⁴ Corruption and poor allocation of resource wealth is an especially prevalent problem associated with resource dependence.

Resource booms (like that of oil in the 1970's) accentuate the problems that already exist within a society. The political environment becomes even more corrupted and the allocation of the increased revenue is squandered on an even greater scale. A resource boom rather than holding out the prospect of kick

² Gelb, Alan H, *Oil Windfalls: Blessing or Curse?* (Oxford University Press, 1988)

³ Robinson, James A, Torvik, Ragnar and Verdier, Thierry, *Political Foundations of the Resource Curse*, Working paper 33, University of California (Berkeley, 2003).

⁴ Jensen, Nathan and Wantchekon, Leonard, 'Resource Wealth and Political Regimes in Africa', *Comparative Political Studies*, Vol 37, No 7, September 2004.

starting a positive trend in development, instead provides corrupt governments with an even greater grip on power.⁵

Thus the literature is clear upon the point that an abundance of natural resources (and especially an abundance of oil) can not only have a major impact upon the type of development path a state takes, but also the political environment of that country. These conclusions though have been based upon increasingly distant events, such as the 1970's oil boom, and it may be the case that the political environment has changed to one that is far more likely to stimulate economic growth. Thus the inevitability of the resource curse is not certain, and the impact of the recent boom has yet been untested.

It is my belief that the political environment has in fact changed to one where resource wealth is better managed and the prospects of development are greatly improved. First, there now exist a much greater quantity of democracies within Sub-Saharan Africa. Since the end of the 'Third Wave of Democracy' there has been a decline in authoritarian regimes and an increase in levels of political freedom.⁶ Second, the international environment has changed to one where global bodies such as the IMF and World Bank have been able to place greater pressure upon developing states to invest their resources more wisely, and reduce levels of corruption and mismanagement. Finally, within the resource industry itself, companies like Chevron and Shell have taken it upon themselves to ensure that business practice becomes more transparent, and that companies and developing states are made more accountable to the people.⁷

⁵ Ibid.

⁶ Huntington, Samuel P, *The Third Wave: Democratization in the late Twentieth Century* (Norman: University of Oklahoma Press, 1991).

Bratton, Michael and Van De Walle, Nicolas, *Democratic Experiments in Africa: Regime transitions in comparative perspective* (Cambridge UK, Cambridge University Press, 1997)

Lindberg, Staffan, *Democracy and Elections in Africa*, (Johns Hopkins University Press, 2006)

Bratton, Michael, Mattes, Robert B and Gyimah-Boadi, Emmanuel, *Public opinion, democracy, and market reform in Africa*, (Cambridge University Press, 2005)

⁷ Karl, Terry Lynn and Ian, Gary, *Bottom of the Barrel: Africa's Oil Boom and the Poor*, (Report for the Catholic Relief Services, June, 2003)

The literature which I have so far reviewed is thus made problematic, because it has not yet been determined that the recent surge in prices has had the same negative impact upon the prospects for long term development. It may be that the changing political climate has meant that the worst effects of the resource curse have been avoided, and that the rapid rise in oil prices has led to economic growth. I hope to test the general consensus that resource dependence and especially resource booms have a negative impact upon the prospects of economic growth. By highlighting the improvement in political environment and the better use of resource allocation amongst current oil producers, I hope to revise the general opinion that the effects of a resource windfall are damaging to long term economic growth.

That there exists a resource curse has been well documented by past scholars, I now analyse those explanations that have been put forward to explain why resource dependence can be so damaging.

The Cause

Explaining the resource curse from an economic perspective

Economic explanations for why a single commodity such as oil can have such a negative impact upon growth, is outlined by the 'Dutch Disease model'.⁸ The theory argues that the over-reliance upon one commodity sector such as oil, leads to the decline of other areas of economic production, and the inflow of foreign capital (through the booming sector) overvalues the exchange rate. This scenario in turn creates a greater reliance on imports, services and speculative activity rather than long term investment.⁹ The oil sector effectively overvalues the currency to the detriment of other domestic exporters, and government resources (in terms of labour, services and infrastructure) are usually channelled into the

⁸The 'Dutch Disease', is derived from the Dutch experience of negative economic downturn, following the discovery of large natural gas reserves in the Netherlands in the 1950's. The economic model is based closely upon the 'linkage approach' theory outlined by Hirshman in the 1970's. See: Hirshman A. O, 'A Generalized linkage Approach to Development', in M. Nash (ed.) *Essays on Economic Development and Cultural Change*, (University of Chicago Press 1977).

⁹ Karl Terry Lynn, *The Paradox of Plenty: Oil Booms and Petro-States*, (University of California Press, London, 1997).

single booming industry, and are less likely to be used to encourage development in other sectors. The oil and resource industry is not as labour intensive as agriculture or large scale industry, it employs far fewer people, and economic benefits are extremely localised. All of this leads increasingly to an unbalanced economy based solely upon the single resource sector.

According to the theory, a sudden price hike in one sector of the economy (like that of oil in the 1970's), or the advent of new discoveries, accelerates the negative effects of the Dutch Disease upon other sectors of the economy (such as agriculture or manufacturing). 'Persistent Dutch Disease provokes a rapid, even distorted, growth of services, transportation, and other non-tradables while simultaneously discouraging industrialization and agriculture, a dynamic that policymakers seem incapable of counteracting'¹⁰

This economic explanation of the resource curse is problematic, because it does not give sufficient emphasis to the flexibility that governments have to deal with such a scenario. If states undertake the correct policies and use their increased wealth wisely, the consequences associated with the 'Dutch Disease' do not have to be inevitable.

Economic explanations for the resource curse are useful in explaining the many economic problems that resource states face when managing their natural wealth. Economic theories in themselves though are not sufficient to explain why developing oil rich states often have such negative patterns of growth. With the right political environment in place, states can initiate policies that are able to overcome these damaging economic factors associated with resource dependence. Indeed, I argue that the positive political changes that have occurred in recent years will mean that states have undertaken policies that neutralise

¹⁰ Neary, Peter J, and Van Wijnbergen, Sweder, '*Natural Resources and the Macroeconomy: A Theoretical Framework*', In J. Neary, ed., *Natural Resources and the Macroeconomy*. Cambridge: MIT Press.

many of the negative economic repercussions. Such economic models of explanation are thus made problematic in the current era because they are based upon the actions of states in a previous era, in which the political environment was considerably different from the one that now exists today across much of Sub-Saharan Africa.

I now turn to discuss the importance of political regime, and the effect that this has upon the way that states allocate their resource wealth.

Political regimes and the effects of oil

In the past two decades a growing body of literature has sought to explain the causal link between oil wealth and authoritarian regimes. For many analysts the abundance of oil revenue provides authoritarian states with a great degree of autonomy from the population; in effect these states do not need to collect taxes from the general population, and are able to maintain their position due to the enormous oil rent alone. Oil revenue effectively creates an environment where there is less political accountability and the regime is able to spend larger amounts of money on patronage, and thus reduce the pressure for greater democracy.¹¹ Collectively, these oil induced actions produce what is known as the 'Rentier State'. A state that is authoritarian in nature, reliant entirely upon external oil rents to maintain itself, and has in place major barriers to democratic change and economic development.¹² One of the most unfortunate aspects of this 'political curse' is that it subsequently effects the ability of a state to utilise its resource wealth to undertake economic development.

By following the right policies, natural resources should be a boon not a curse. But the policy choices that a state will make are not always made in a rational

¹¹ Ross, Michael L, 'Does Oil hinder Democracy?' World Politics 53, (April 2001).

¹² The first definition of the term was outlined by: Mahdavy Hussein, *The Patterns and Problems of Economic Development in Rentier States: The Case of Iran*, in Cook, M. A, ed., *Studies in Economic History of the Middle East* (London: Oxford University Press, 1970); Later adjustments to the definition were added by: Beblawi, Hazem, *The Rentier State in the Arab World* (New York: Croom Helm, 1987).

environment. Auty explains that in different ways, the different types of state will determine how rents are used and thus the general path of development. For example if a state is factional in nature, it is less likely to formulate effective policy control over a commodity windfall, compared to a 'developmental state' that has a much more stable political environment in which beneficial policy can be undertaken.¹³

Often the most important factor in determining how resource states can utilise their income, is whether they have a stable political environment in which resource wealth is allocated into areas that will stimulate long term growth. Analysts have found clear empirical support that those states with greater stability and higher levels of democracy were more likely to outperform authoritarian states, in terms of allocation of resource wealth and subsequent growth.¹⁴ According to such a view the question of regime type has a major bearing over the type of economic policy undertaken, and thus the prospects of long term economic development.

The literature is clear, the political environment has a major bearing upon how resource wealth is used; it is also clear that the political environment is very much effected by the exploitation of natural resources (especially in the case of oil).

Having identified the negative economic and political aspects of the 'resource curse' scholars have subsequently focused a great deal of attention to investigating how these factors can be overcome.

¹³ Leftwich, Adrian, *'Bringing Politics Back in: Towards a Model of the Developmental State'*, The Journal of Development Studies, Vol 31, No. 3, February 1995, pp400-427.

¹⁴ Auty, and Mikesell, *Sustainable Development in Mineral Economies*, (1998)

The Solution

What can be done to avoid the resource curse?

Scholars are agreed that the resource curse is not a symptom that is inevitable to resource dependent states. There are certain measures that states can undertake to overcome the most damaging aspects of 'the curse'.

First of all, whether a state is 'developmental' or 'factional', will according to the literature, have a major bearing upon whether a state is able to avoid the resource curse.¹⁵ The factional regime (characterised as being interested only in its own survival) is more likely to undertake rent seeking behaviour, have a distorted economy and ultimately a negative pattern of growth. Alternatively a developmental state (characterised by its focus upon building up its administrative and economic capability) is far more likely to undertake a successful strategy for utilising its resource wealth and thus stimulating development. Key to overcoming the resource curse is having the right political system in place. This especially means having strong democratic institutions at the outset of a resource boom. Robinson explains that:

'The overall impact of resource booms upon the economy depends critically on institutions since these determine the extent to which political incentives map into policy outcomes. Countries with good institutions tend to benefit from resource booms since these institutions mitigate the perverse political incentives that such booms create; In tern countries with bad institutions may suffer from a resource curse'¹⁶

The first step then in overcoming the resource curse is to have in place the type of political regime and institutions that are able to avoid the pitfalls of resource led development. Ideally, that regime is stable and based upon strong democratic institutions.

¹⁵ Lal, Deepak, *Why Growth Rates Differ*, in B. H. Koo and D. H. Perkins (eds) *Social Capability and Long term Economic Growth* (Macmillan, 1995).

¹⁶ Robinson, James A, Torvik, Ragnar, and Verdier, Thierry, *Political Foundations of the Resource Curse*, Working paper 33, University of California (Berkeley, 2003).

The second step is to initiate the type of economic policies that will negate the most damaging consequences of the resource curse. In terms of resource allocation and how states should use their resource wealth, the literature is quite clear. The emphasis is upon caution. Most central to this adoption of a cautious development strategy is the establishment of a 'Mineral Fund', that sterilizes the resource wealth, protecting the economy from the worst effects of the Dutch Disease and other side effects of the resource curse. Such a cautious approach protects the state from fluctuations in the exchange rate, and counters the unpredictability of the revenue stream. In effect, it smooths over the worst elements of the boom – bust cycle, and prevents governments acting on overoptimistic assumptions that commodity prices will remain high. Scholars are agreed that if resource wealth is to be used wisely (especially in the time of a price boom) then major spending programmes should be avoided¹⁷, economic institutions should have a greater degree of control and autonomy from central government, and a large proportion of the wealth should be saved or used to pay off external debt. Borrowing should be avoided at all costs.¹⁸

The literature makes clear how oil states should use their oil wealth if they are to encourage economic growth and avoid those factors associated with the resource curse. Allocation of funds should be conservative and focused upon saving, rather than undertaking large scale public projects, and the political environment should be one that is conducive to these policies being undertaken.

Critique of the Literature

Our state of knowledge is problematic because it has yet to be tested against recent experience. The changing political landscape since the 'Third Wave of Democracy', coupled with an increased international focus on good governance

¹⁷ The importance of reducing government control over the allocation of resource wealth, is based upon the premise that decisions made by an incumbent regime, may be influenced by political considerations and external pressures (such as the need to maintain a system of patronage) rather than sound economic rationale.

¹⁸ Auty and Mikesell, Sustainable Development in Mineral Economies, (1998)

and political freedom, leads me to believe that the prospects of resource rich states realising their resource potential has greatly increased. The current literature though remains unclear and key questions remain unanswered; have the oil producing states been able to improve the political environment to one that is more beneficial to positive change? And have they been able to allocate their increased wealth in a manner that holds out the prospect for long term economic growth? In effect the recent experience of soaring oil prices creates an excellent opportunity to put our existing knowledge to the test.

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Chapter 3

Research Design

To accurately assess whether Sub-Saharan oil states have indeed improved their political environment and the way that they allocate their oil wealth, I will use two types of research design. First, I will conduct a cross national analysis of all Sub-Saharan states between 2002-2006, secondly I will undertake an illustrative case study of Nigeria and outline its political and economic experiences both during the 1970's and early 1980's, and the 21st century oil booms.

The purpose of first undertaking a cross national analysis is to attain three core objectives. The first objective is to measure the degree to which states have progressed politically since the 1970's. The second objective of is to identify the main oil producers in the region and their changing levels of oil wealth in the period 2002-2006. Finally, drawing upon data from the World Bank and International Energy Agency, I identify how states have allocated wealth by testing the correlation between oil production and wealth allocation.

The range of the study is one that does not focus just upon those major oil exporters; it also encompasses the whole of Sub-Saharan Africa, and thus makes possible a comparison between the resource allocations of oil states with those non oil-producers in the region. I will thus be able to identify whether the patterns of investment and resource allocation within the oil states are unique, or in contrast, whether they are part of a wider regional trend.

To help validate my findings and more conclusively test the link between oil production and other areas of government spending, I will be using three control variables that I hope will emphasize the point that patterns of resource allocation within petro-states are due to increased oil prices, rather than wider regional trends. I will be controlling for regional changes in levels of Gross Domestic Product (GDP), Foreign Investment and total exports.

In terms of my second research design, I will undertake an illustrative case study on Nigeria that emphasises and supports my main points, that the political environment has changed for the better, and that resource wealth is being used far more constructively in the contemporary period.

Nigeria exemplifies I believe, the wider trend of positive change that is occurring across the region, in terms of how states are using their resource wealth, and thus I hope such a case study will compliment my empirical findings with a detailed case analysis.

Data:

Political Regime

My first objective is to measure levels of democracy and freedom within the selected petro-states and across the wider region. I hope to test whether the political environment has improved from the 1970's in terms of being more conducive to positive economic development. Using data from Freedom House, I will create variables which measure changing levels of political freedom in the current price boom period, compared to those of the past. I hope to show that there has been (if only marginally) an improvement in the political environment since the outset of the 1970's oil boom, a factor that holds out the prospect of oil wealth being used in a more productive manner to stimulate long term growth and development. The purpose of using this data is to establish whether democracy and good governance has increased, or whether oil states are still hindered by the same regimes that were so instrumental in wasting their oil wealth in the 1970s?

'The 'Freedom House Data Set' measures political rights and civil liberties, or the opportunity for individuals to act spontaneously in a variety of fields outside the control of the government and other centres of potential domination. As such, the survey is primarily concerned with freedom from restrictions or impositions on individuals' life pursuits. The survey does not

*explicitly measure democracy or democratic performance. Rather, it measures rights and freedoms integral to democratic institutions'*¹⁹

This type of measure is important to my study because one of the key aspects of the 'rentier effect' is to constrain civil society and reduce civil/political institutions to the will of the central government. Whether a state is able to utilise its resource wealth is greatly dependent upon the degree to which the institutions (especially economic) and civil society are free from the control of central government.²⁰ The time range of the 'data set' is also one that allows me to make direct comparisons between 'freedom scores' at the outset of the oil boom in 1973, to the start of the recent price-hike, (2002). Thus allowing me to be able to identify what type of political environment existed within the specified states at any given time.

Identifying Africa's Oil Producing States.

In terms of the second key objective (identifying Sub-Saharan African petro states) I will use data collected from the International Energy Agency and the OECD energy information website. The data which I have collected shows the level of oil exports per country per year from 2002 to 2006, it also gives the global prices of oil for any given year. From these figures I can measure the amount of yearly oil revenue flowing into a state, and thus ascertain the yearly average within my specified time range. The reason for creating this data set is so that I can clearly identify Sub-Saharan oil producers, and if need be, I can categorise them into different levels of 'oil wealth'. That is to say I can identify the biggest producers from those that only have a marginal level of output.

I will also collect data (from the same sources) that measure the percent of total country exports which are due to oil revenue. By measuring a country's total export revenue, and then deducting that total with the amount of total export revenue generated from oil exports, I will be able to identify how great a

¹⁹ Written Statement taken from the Freedom House website.

<http://www.freedomhouse.org/template.cfm?page=277>

²⁰ Robinson, (2003), Wantchekon, (2004)

proportion of the export revenue is generated from oil production alone. The reason for creating this table is that it will highlight the degree to which a state is reliant upon oil. Whereas the previously discussed table assesses the total level of 'oil wealth' flowing into a state, this table will show how dependent states are upon that 'oil wealth' within the wider economy.

I will also use this data to create an 'oil wealth variable' that I will use as an independent variable to test against a set of public sector indicators. Thus I hope to be able to check which areas of public spending correlate most closely to increased oil revenue. By identifying such correlations and patterns of spending, I will be able to identify those areas in which increased revenue has been allocated (such as health, manufacturing and national savings). In effect I am identifying the major oil producers of the region, calculating their level of oil revenue and investigating whether the dramatic increase in oil wealth in this period, correlates into increased government spending, and if so, specifically into what areas?

Resource Allocation

In regard to my third main objective, to find out how Sub-Saharan states are using their increased resource wealth, I have collected data from the World Bank: World Development Index. Using these statistics I can assess into which particular sectors governments are placing their revenue, the amount they are saving and the amount that is being allocated into paying off foreign debt. Thus I have created a set of indicators that show the year on year levels of state funds, measured as a % of Gross National Income (GNI), that have been allocated into public health, agriculture, manufacturing, services, infrastructure, the military, national savings and servicing the foreign debt.

By measuring these indicators it is possible to find out how states have been allocating their oil wealth in the boom period. By measuring the areas and levels of government spending in the recent era of inflated oil prices, I hope to be able to answer the question of whether SS African oil states are making the same

allocation mistakes as their predecessors in the 1970's or whether there has been improvement?

Control Variables

I plan to create three control variables that will measure change in GDP, Foreign Direct Investment (FDI) and total exports across Sub-Saharan Africa between 2002-2006. Data will be drawn from the World Bank, World Development Indicators and the range will include all Sub-Saharan states.

The reason for creating these control variables is so that I can prove that the change in resource allocation is indeed due to the increase in oil wealth, rather than external factors. Such factors may be an increase in GDP across the region, increased levels of foreign investment or a growth in the volume of external trade.

By creating these 'controls' I hope to discount the possibility that patterns of resource allocation within Sub-Saharan oil states is due to wider regional trends rather than the increase in oil revenue. I hope to run 'partial correlations' between my independent variable (oil wealth) my dependent variables and then also my control variables, and thus establish the strength of my original correlations. In effect my data will be held constant against such factors as changing levels of GDP, FDI and Total Exports across the region.

Sources of Data:

- Freedom House.
- World Bank, Worldwide Development Indicators CD-ROM
- World Bank, Worldwide Governance Research Indicators Data Set.
- United Nations, UNESCO, UN statistics division.
- United Nations, Human Development
- Organisation for Economic Co-operation and Development (OECD) Country Fact book
- The international Energy Agency

- Alan H. Gelb, Oil Windfalls: Blessing or Curse? (1988)
- Jeffrey D. Sachs and Andrew M. Warner, Natural Resource Abundance and Economic Growth (1995)
- Jeffrey D. Sachs and Andrew M. Warner, The Big Push, Natural Resource Booms and Growth (1999)
- Richard M. Auty and Raymond F. Mikesell, Sustainable Development in Mineral Economies (1998)

Case Study:

Nigeria as an example of the wider regional trend

In my opinion, African states have to a certain extent learnt from previous lessons, that oil wealth must be used more conservatively and with greater constraint. Indicative of this wider pattern is the case of Nigeria, which has in recent years undertaken many economic and political reforms which have ensured that oil wealth is better used to stimulate development. Nigeria stands out as a clear example of the wider empirical conclusions that I hope to find, that Africa's oil states have progressed politically and are using their resource wealth in a far more constructive manner than was the case during the last oil boom of the 1970's and early 1980's.

I hope to use the case of Nigeria to highlight the disastrous use of oil wealth in the 1970's and the resultant effect it had upon holding back economic growth, a trend that was reflective of the much wider region. I then plan to investigate Nigeria in the contemporary period and compare the way it is allocating its funds now, and the type of political environment that exists in comparison to the earlier period. It is my belief that just as Nigeria was representative of the wider region in terms of the misuse of funds in the 1970's, so the country is now a good example of the types of reforms that have been set in place which allow for greater resource led development. I hope to use this case study as a compliment to the empirical data that I have collected and thus give a point of focus to the wider patterns that emerge within the empirical analysis.

Measurement:

The following is a description and definition of the variables I plan to use to support my hypothesis.

'Oil wealth'

The variable 'oil wealth' will measure the total change in the level of oil income between the years 2002-2006. The variable takes the total oil revenue from the base year 2002, and then measures the total increase (or decrease) between that year and 2006.

The level of oil income is **not** measured as a % of GNI, nor is it broken down in relation to the size of the national population. It measures instead the total oil revenue as projected by the total amount of oil exports. Rather than focusing upon a per capita assessment of the increase in oil revenue I am focusing just upon the amount that flows directly to the government itself, so that I can have a more accurate measure of the amount of oil revenue a government has to allocate.

Thus the oil wealth variable is a measure of how great an increase (or decrease) of revenue has accumulated to the specific government within the given period (2002-2006). It is not measured in relation to the size of the population, but simply the total amount of oil revenue generated by export sales.

The time span is one that starts with the beginning of the price increase period (2002) and ends in that year in which the most up to date data can be obtained (2006).

I will use 'oil wealth' as my **independent variable** in which I plan to test whether increases in 'oil wealth' correlate into increases in 'social spending', 'servicing the external debt' and 'national savings'. I hope to find that increases in oil wealth have led to an increased allocation of funds into national savings and servicing the external debt and only a modest growth in terms of social spending. Such a scenario would indicate that the increased revenue has been used in a far more responsible and constructive manner than the previous boom period, which saw

an enormous increase in social spending, a reduction in national savings and an enormous increase in external debt. The result of which was to leave a lasting legacy of underdevelopment.

My sources for the relevant data will come from The International Energy Agency (IEA) and the OECD Energy Statistics Division. Both sources have sites that give the amount of oil exported from each Sub-Saharan country, per year (by the barrel). They have a list of average oil prices by year (by the barrel). By calculating how much oil states are exporting and the average price of that oil in the given year I will be able to formulate exactly how much oil revenue is being generated by these states on a yearly basis.

'Public Sector Spending'

The variable 'Public Sector spending' measures the change in government revenue into key public sectors between the period 2002-2006.²¹ These sectors include agriculture, manufacturing, health, military, infrastructure and education. These sectors represent the main public areas of catchment where one would expect to find the investment of increased oil revenue. I will collect the data from the World Bank, World Development Indicators and the United Nations (UN) Human development Index.

This variable although termed under one heading (public sector spending), is actually made up of separate variables in which each public sector is represented. There does not exist then, one variable that encompasses all areas of public spending, but rather each of the main sectors has its own variable which will be assessed collectively under the title public sector spending.

²¹ All changes between 2002-2006 are measured as a % of GNI. Standardising the measurement makes it easier to make a cross sector comparison.

The indicator then is one that does not measure the total amount of money that has been allocated into any of these specific sectors, rather it measures the increase or decrease in levels of government revenue between 2002-2006. The reason for this level of measurement is so that increases (or decreases) in oil wealth can be directly correlated to the increases and decreases of revenue being allocated into these specific sectors. Measuring just the change in allocation between the two set dates (2002-2006) allows me to locate where and in what quantity extra oil revenue is being invested.

The number of cases will include all of Sub-Saharan Africa (46 cases) so that the pattern of resource allocation can be tested across the continent. The reason for this is so that I can identify whether oil-states are allocating a greater amount of wealth than their neighbours or whether these states and the way they allocate their wealth is simply part of a wider regional trend.

I hope to show that in terms of resource allocation, oil states are not undertaking enormous programs of public expenditure like that of their predecessors.

'External Debt'

This variable measures the change in the amount of external debt between 2002-2006. By measuring the change for each Sub-Saharan state (measured as a % of GNI), it is possible to identify how much debt has been paid off in the specified period by each country, or whether their levels of debt have increased. Using oil wealth as the independent variable it is possible to look for correlations that exist between rising levels of oil wealth and reductions (or increases) in the levels of external debt. Data will be taken from the World Bank, World Development Indicators.

I hope to find that increased levels of oil wealth have resulted in a dramatic reduction in the level of external debt. I expect to find that oil states outperform the rest of the region in terms of their debt reduction. Alternatively, it may be the

case that increased oil wealth has led to petro-states increasing their levels of debt which was the scenario during the 1970's oil boom.

'National Savings'

This variable measures the change in the amount of money being saved by the government (as a % of GNI) between 2002-2006. By creating this variable it is possible to establish whether the increase in oil revenue correlates into an increase in the levels of savings, or whether an increase in oil has led to less money being saved and a greater amount being invested. I will be using data taken from the World Bank, World Development Indicators.

The range of the variable will be one that encapsulates all of Sub-Saharan Africa.

I hope to find out whether oil states are saving more than other countries in the region, whether they are reducing the level of savings in relation to oil wealth or whether the oil boom has had little impact. In relation to my hypothesis, whether states save or spend their increased wealth is extremely important to determining their chances of development. The literature that surrounds the topic of oil wealth and development is agreed upon the point that saving increased wealth is essential to staving off the worst effects of the resource curse. In the previous boom period states spent rapidly rather than saving for the future and sterilizing the new wealth, the result was often a disrupted economy and increased levels of debt, that allowed for the worst aspects of the resource curse to take hold.

Sub-Hypothesis:

I expect to find that in comparison to the outset of the oil boom in 1973, the contemporary political environment will show a marked improvement in terms of stability and democratic practice. Due to this improved political environment I expect to find that Sub-Saharan oil states have not repeated the same resource allocation mistakes as their predecessors. It is my belief that the very worst affects of the 70's price boom will have been avoided, and that the prospects of resource led development are greatly increased in the 21st century.

- 1) In the area of '**Social Spending**' (that includes all the different public sectors; education, health, services, agriculture, manufacturing and infrastructure) I expect to find that levels of spending will not be out of line with non-oil producing states. Unlike the previous oil boom when enormous sums of money were pumped into social spending, I expect that this time around investment will be much more modest. In short, spending patterns will be much more conservative and the major social spending projects that were the hallmark of the previous price hike period will be absent. I believe that the international political environment is now one that favours a more responsible, reserved approach in terms of allocating oil wealth. For example, oil companies and organisations such as the World Bank have become more focused upon ensuring that states use their oil wealth responsibly in comparison to the previous oil bonanza, when national governments had few credible guidelines to follow. There exists a greater measure of political freedom across the continent and there exists a great deal of knowledge (learnt from the bitter experience of the previous bonanza) that resource wealth must be used in a more conservative manner.
- 2) In the area of '**external debt**' I would expect to see a major reduction in the level of foreign debt amongst Sub-Saharan oil producers. I expect to find this due to the fact that debt reduction has become the major goal of many

African countries in recent years, following the encouragement of conditional aid from the international environment. The reduction of debt is an important factor related to my general hypothesis because by showing that producers are now actually reducing their levels of debt rather than increasing them, one of the most damaging factors that effected development in the wake of the previous oil bonanza will have been overcome.

- 3) In the area of **'national savings'** I expect to find a marked increase in the amount of money being saved by the government. I believe that states in the contemporary period, rather than undertaking enormous public projects are more inclined to save their wealth and thus offset the most damaging consequences of the resource curse. The experience of past failures in terms of how resources were used, coupled with the changing political climate, are factors that lead me to believe that states will focus on saving, rather than spending there new found oil wealth.
- 4) In terms of the **'political environment'** I hope to show a modest improvement in levels of democracy, political freedom and accountability. Whilst I don't expect there to be a major break from the past, I expect that the political environment has changed to such an extent that a more constructive use of resource wealth and economic development seems a far more likely prospect. The reason for this optimism is that within the international political sphere there has been dramatic change in the past two decades. The fall of the Soviet Union and the 'wave of democracy' that followed its collapse was keenly felt in Sub-Saharan Africa, and encouraged many African states to seek political reform. There exists now a much greater emphasis upon democracy and good governance across the region, with powerful states such as the USA giving strong external incentives to reform authoritarian regimes.

Conclusion

Using SPSS, I have created a set of variables that measure the change in levels of oil wealth and also levels of government expenditure within certain key public sectors. From these variables I can ascertain the pattern of resource allocation that oil rich states are undertaking, whether they follow the same broad trends as the 1970's, and whether they are wholly different from the wider region. To the question of whether Sub-Saharan oil states are making the same mistakes as before I hope to find conclusive evidence that they are not, and that in fact their prospects of development are much increased

The time scale of my variables focuses upon a five year period that begins with the rise of oil prices (2002) to the most recent year in which accurate statistics are available (2006). The range of units takes in all of Sub-Saharan Africa. The central focus of this study is to identify whether Africa's oil states are making the same mistakes as they did in the previous era of greatly increased oil wealth, or whether they improved their prospects of long term resource development improved?

Chapter 4:

Africa's Political Environment

The political environment of Africa's oil producing states in the 1970's was one that was not prepared to deal with the huge influx of petro-dollars. Regimes were volatile in nature, economic institutions were weak, and there existed no guidelines or experience of how to utilise and benefit from such an enormous windfall. The rapid rise of oil income which began in 1972 was thus poorly allocated in terms of stimulating long term growth; government's squandered vast sums financing unrealistic public projects, and used the wealth to help maintain their own privileged position. The focus of this chapter is based upon two central objectives; the first is to outline what common political characteristics existed within Africa's oil producing states at this time, and the effect these factors had upon the poor use of oil revenue. The second objective is to identify whether these factors have changed in the current era, or whether this group of states is afflicted by the same political problems? What was it about the political environment of the 1970's and early 1980's that made economic decision making so bad, and has there been improvement in the current era?

Given the common wisdom about the resource curse, especially in Africa, the political and economic consequences of the recent oil boom of 2002-2006 would appear obvious. Yet as I showed in chapter two, much of our wisdom is based only on the analysis of the previous boom of 1973-1982. In this chapter I plan to demonstrate two things. First, that the common authoritarian characteristic of Sub-Saharan states in the 1970's and early 1980's, had a damaging effect upon how resource revenue was used; Second, the domestic political environment, widely cited as an important moderating factor that shapes the particular consequences of the oil boom in a given country, has changed substantially from this earlier period. Whereas in 1972, at the start of the earlier boom, seventy nine percent of Africa's oil producers were authoritarian states, characterized by 'strong man' dictators, and lacking in political and social freedom; by 2001, when

Africa stood at the precipice of a second boom, only forty three percent were authoritarian states.²² I will demonstrate that there has been positive change in the international political environment and in the oil industry itself that should mitigate the worst impacts of an oil boom. International corporations are more likely to undertake a more responsible business practice, that focus's especially upon African governments using their resource wealth in such a way as to stimulate long term growth. Also, International Financial Institutions (IFI's) are now more likely to demand that African states undertake a more transparent use of resource wealth. Such international bodies have become increasingly linked to civil society groups, to create a potent alliance that should result in collective action against those African governments that misuse their oil revenue.

In this first part of the chapter, I outline the authoritarian nature of Africa's oil producers in the 1970's; I assess the impact that this type of political environment had upon the use of resource wealth, and I identify the level of freedom as being the most important factor in determining whether the political environment is to be beneficial or not to resource based development. Thus I argue that the degree to which a state is authoritarian or democratic (and the subsequent effect this has on state institutions), stands out as a major determinant to whether the resource boom will have a positive or negative effect.

Africa's political landscape and the impact of the 1970's oil boom

The last oil boom began in 1973, and in just that first year, oil prices more than quadrupled, the price slowly increased from 1975 to 1978 and then doubled again between 1979-1981. The enormous rise in the cost of petroleum took the world by surprise, and saw an enormous transfer of wealth from oil importers to those exporters. At the time of the initial price hike, the major exporters around the

²²Information taken from Freedom House. <http://www.freedomhouse.org/template.cfm?page=277>

world were seen as the winners in this major shift in global economics. In time though, many of those states that had made such enormous profits from their oil revenue were in dire economic straits, indeed they were worse off than they had been before the oil boom began. In Africa, the oil boom of the 1970's and early 1980's, rather than sowing the seed for future development, acted as a force that held back positive growth and left many petro-states saddled with enormous debt and economic stagnation. Central to this predicament was the authoritarian nature of regimes in this period, and the subsequent effect this type of regime had upon the ability of state institutions to formulate sound economic policy.

Africa's Authoritarian States

At the outset of the oil boom in 1972, African states lacked any consistent measure of political freedom and were entirely authoritarian in nature.²³ The effect of this political situation upon how revenue was used was to be a major factor in determining the regions failed development.

Studies from the oil boom of the 1970's clearly show that the type of political regime within a given state, would determine the prospects of that state using its resource wealth to follow a positive development trajectory.²⁴ The vast majority of petro-states, and especially those in Sub-Saharan Africa, undertook disastrous resource policies due to a political environment that forced policy makers into irrational decisions which held out little prospect of successful investment and long term growth. The nature of the authoritarian state²⁵ ensured that the use of

²³ See table 1, p35

²⁴ Auty and Mikesell, *Sustainable Development in Mineral Economies* (Clarendon Press, Oxford, 1998)

Gelb, Alan H, *Oil Windfalls: Blessing or Curse? A world Bank Research Publication* (Oxford University Press, 1988).

Karl, Terry Lynn, *The Paradox of Plenty: Oil Booms and Petro-States*, (University of California Press, London, 1997).

²⁵ The definition of the authoritarian state is taken from Freedom House, which measures civil rights and political liberties for individuals. Whether a state is authoritarian or not, is largely determined by governmental and non-governmental constraints upon individuals and their ability

oil wealth was more likely to be based upon political considerations rather than sound economic objectives. The authoritarian environment also ensured that there existed no authoritative or autonomous state institutions that could ensure a more responsible use of resource funds.

From a quantitative perspective, the statistical evidence is clear upon the point that the more authoritarian the state, the less likely it is that resource wealth will be used to successfully stimulate long term growth. Analysts are agreed upon the same point, that states with higher levels of political freedom are far more likely to undertake a more responsible use of their resource wealth.²⁶ Auty summarises these findings, stating that of all those states in his study:

*'The states which performed less well (in terms of long term economic growth) were all authoritarian states whose internal divisions constrained government action and/or emphasized redistributive objectives at the expense of the efficient use of resources'*²⁷

Qualitative studies have also highlighted the same conclusions, that states with greater freedom and less authoritarian rule, are far more likely to undertake sustained economic growth based upon resource revenue. Brian Pinto, in his comparative study between Nigeria and Indonesia in the 1970's, showed that whilst both states had a great number of similarities in terms of their economy and size of population, the long term impact of the resource boom was wholly separate. Indonesia was able to sustain long term growth whilst Nigeria squandered its increased wealth and was subsequently paralysed for many years. Pinto identifies the differing political environments as key to determining the diverse outcome of the resource boom. Pinto believes that the strict authoritarian nature of Nigeria at this time, ensured that economic decision making was hampered by political issues, and that subsequently resource wealth was poorly

to practice the rights and freedoms integral to democratic institutions.

<http://www.freedomhouse.org/template.cfm?page=277>

²⁶ Akanni, Olomola, *Oil Wealth and Economic Growth in Oil Exporting African Countries*, African Economic Research Consortium (AERC) Research Paper, Nairobi, No170, September 2007.

Auty and Mikesell, *Sustainable Development in Mineral Economies* (Clarendon Press, Oxford, 1998)

Ross, Michael L, *'The Political Economy of the Resource Curse'*, World Politics 51 (January 1999), 297-322.

²⁷ Auty, (1998), p102.

allocated. In comparison, Indonesia had a strong measure of political freedom, firmly established democratic institutions and thus the right political environment in which sound economic decisions could be made. Pinto also points to the other mineral rich states of the period, such as Norway and Botswana, which were able to utilise their resources and achieve lasting growth. All shared a similar characteristic, they had strong democratic tendencies.²⁸

Whilst in other parts of the world (such as Norway and Indonesia) oil wealth was managed in a more responsible manner due to strong democratic institutions and greater political freedom, the African experience during the 1970's oil boom was one where money construed straight into the hands of authoritarian regimes.²⁹ These states in turn used that wealth to support their own position to the detriment of democracy, and development. The inflated resource revenue simply became a means by which the authoritarian state could maintain its power and prevent opposition.

An example of the way that Sub-Saharan states misused their resource wealth, is given by Leonard and Wantchekon, they explain that during the period of the oil boom (in Africa), 'politics became dominated by issues concerning the distribution of resource rents'. As well as outright patronage, states often allocated wealth into areas that would garner greater support for their regime, creating social groups that were reliant upon the government and the existing economic system for their particular status. Large spending in the public domain and the military is often attributed to this situation.

'In mineral rich Guinea over 50,000 civil servants consumed over half of the budget. In Nigeria, employment in the civil services exploded, fuelled by

²⁸ Pinto, Brian, 'Nigeria During and After the Oil Boom: A policy Comparison with Indonesia', The World Economic Review, Vol 1, No. 3 (May, 1987) pp. 419-445.

²⁹ Rodrik, Dani, Subramanian, Arvind and Trebbi, Francesco, *Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development*, NBER Working Paper No. 9305. (National Bureau of Economic Research, Cambridge, October 2002).

Robinson, James, Torvik Ragnar and Verdier Thierry, *Political Foundations of the Resource Curse*, (Working Paper, Department of Political Science and Department of Economics, University of California at Berkeley, October 16th 2003)

Melum Halvor, Karl Ove and Torvik, Ragnar, *Resource Abundance, Growth and Institutional Quality*, (Unpublished Department of Economics, University of Oslo, 2002)

revenues from the sale of oil. In Cameroon relatively modest oil wealth was used as an information advantage and resource to buy support, and in the Congo the size of the military was vastly expanded' ³⁰

As the authors make clear, in all of the above the sole purpose of the authoritarian government was to help maintain its own position and stifle opposition. The expansion of the civil service and bureaucracy in countries such as Nigeria and Guinea had no actual benefit to the state and did little to improve governance or the economy; instead it was simply a way of garnering support for the regime, an experience which is especially predominant amongst authoritarian states.³¹

In effect, Africa's authoritarian political structure at the outset of the oil boom created a situation in which the worse aspects of the resource curse could prosper.³² Focused only upon their survival, incumbent regimes failed to enact policies that would avoid the worst effects of 'the curse' (like the Dutch Disease) and they failed to stimulate any kind of long term economic growth. To summarise, the type of authoritarian regime which existed in Sub-Saharan Africa at this time, resulted in poor decision making due to political issues taking precedence over sound economic rationale.

The role of Economic Institutions

Another characteristic of Sub-Saharan states in this early period was that economic institutions (such as economic planning agencies) were generally weak and lacked autonomy, if they existed at all.

It was often the case amongst African states in the 1970's, that institutions were used simply as a tool by which the particular regime could dictate policy. These 'grabber friendly' institutions, rather than serving the interests of the general

³⁰Wantechekon (2004), p 820.

³¹ For more in depth detail of misguided government policy and misallocation of resource wealth in the 1970's and early 1980's see chapter 6.

³² Ross, Michael L, 'The Political Economy of the Resource Curse', World Politics 51 (January 1999), 297-322.

populace, were beholden entirely to the government and had little freedom to allocate wealth in a constructive manner.³³

Akanni outlines the important functions that economic institutions undertake and the effect they can have upon economic performance. The author states that:

*'Economic institutions are crucial to rapid economic growth because they shape the incentives of key economic actors in society; in particular they influence investments in physical and human capital and technology, and the organisation of production. It has been documented that differences in economic institutions are the major source of cross-country differences in economic growth and prosperity'*³⁴

Amongst the literature there is a general consensus that the ability of a state to have in place economic institutions free from political pressures, free from the effects of regime change, and able to maintain some kind of stability and continuation of economic policy, is essential to achieving long term economic growth.³⁵

Robinson summarises this point, explaining that:

*'The general notion that emerges from this literature (the resource curse) is that a primary problem with resource rents arises when they accrue to the government and these revenues allow the government to engage in economically inefficient but politically rational actions'*³⁶

Unfortunately, amongst Africa's authoritarian states of this early period, there existed little measure of freedom at the institutional level, and thus the ability of economic institutions to play any effective part in ensuring that resource funds were allocated properly was lost.

³³ Akanni p6

³⁴ Ibid, p4

³⁵ Rodrik, Dani, Subramanian, Arvind and Trebbi, Francesco, *Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development*, NBER Working Paper No. 9305. (National Bureau of Economic Research, Cambridge, October 2002).
Dollar, D and Kray, A, *'Institutions, Trade and Growth'* (Journal of Monetary Economics, 50: 133-62, 2003).

Vijayaraghavan, M. and Ward, W. A, *Institutions and Economic Growth: Empirical Evidence from a cross-national analysis*, www.business.clemson.edu/cit/Documents/001302.pdf

³⁶ Robinson (2003), p3.

Drawing again upon Pinto's comparative study as an example, it is possible to identify the weak character of Nigeria's economic institutions as a key factor in determining that states development and growth failure. In comparison, Pinto emphasises the strong institutional capability of Indonesia as a decisive factor in determining that states success. Having in place strong, independent economic institutions was essential for Indonesian economic decision making and subsequent growth. Nigeria on the other hand was under a strict authoritarian regime in which the freedom of economic institutions was severely restricted and decision making was left entirely in the hands of a small political elite.³⁷ In such a political environment, rational economic decisions were abandoned for the pursuit of those goals which would best serve the interests of the incumbent regime and their supporters.³⁸

In conclusion, the political environment of Africa's oil states in the 1970's, was undermined by a lack of political and social freedom. The type of authoritarian regime (characterized by weak economic institutions and poor decision making) ensured that resource wealth was squandered away on projects that were politically justified (in terms of maintaining power), but economically disastrous to long term development. In any assessment of Africa's progress in terms of its political environment, the key factors which are most important to determining long term economic performance, are the degree to which the state is authoritarian or democratic, and the level of freedom that exists within that given state.

³⁷ Pinto, (1987).

³⁸ For examples of Nigeria's misallocation of resource revenue in the 1970's, see chapter 7

Positive Change across Africa

In this second part of the chapter, I outline the positive steps that Sub-Saharan Africa has taken in terms of improving its political environment; As well as looking at wider regional trends, I also focus upon the petro-states themselves and assess their progression in terms of government practice. The evidence is clear, Sub-Saharan Africa has taken great strides in terms of improving its political environment, and Africa's oil producing states are no exception to this wider trend.

The 'Third Wave of Democracy' which swept over great parts of the globe in the late 1980's and early 1990's was keenly felt in Africa. The collapse of communism reshaped global politics to such a degree that there existed a new emphasis upon democratization, and ordinary citizens living under authoritarian rule were inspired into action by the scenes of dictators being driven from power in the old 'Eastern Bloc'. Roger Southall explains that:

'The early 1990's witnessed a dramatic return of multiparty democracy to Africa; whereas in 1989, 29 African countries were governed under some kind of single party constitution, and one party rule seemed entrenched as the modal form of governance; by 1994 'not a single de jure one-party state remained'³⁹

The collapse of communism meant that conditions could now be attached to foreign assistance without fear of losing allies to communist rivals. Political conditionality, the emergence of Western demands for good governance, and the political mobilization of progressive forces are thought to have contributed (with more or less effect) towards greater democratic transition across Africa.⁴⁰

Using data taken from Freedom House, the following section outlines the positive trend towards greater freedom and democracy which has occurred since the earlier price boom period of the 1970's and early 1980's.

³⁹ Southall, Roger, *Democracy in Africa: Moving beyond a difficult legacy*, (HSRC publishers, 2003), p5.

⁴⁰ Bratton, Michael and Van De Walle, Nicolas, *Democratic Experiments in Africa: Regime transitions in comparative perspective* (Cambridge UK, Cambridge University Press, 1997)

Freedom House Data

Figure 1 shows the average freedom score for oil producers and non-oil producers across Sub-Saharan Africa in the years 1972 and 2001 (the years which were immediately prior to the 1970's, and then the 21st century oil boom). Using data taken from Freedom House, I have combined the scores for 'political rights' and 'civil liberties' to create a single 'freedom' variable. The scale of the table runs from 1 – 7; in which 1 represents the lowest level of freedom, and 7 represents the highest level of freedom.

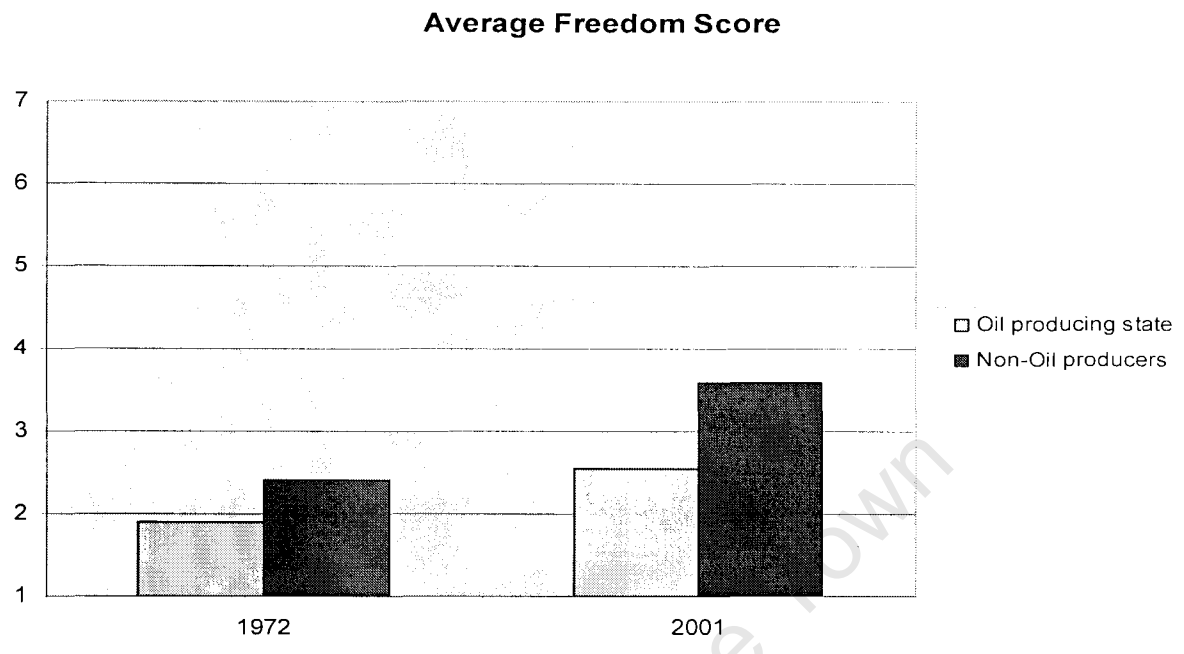
These political rights and civil liberties ratings are combined and averaged to determine an overall "freedom status" for each country and territory. Countries and territories with a combined average rating of 5.5 to 7.0 are considered "Free"; 3.0 to 5.0, "Partly Free"; and 0.0 to 2.5 "Not Free".⁴¹

Freedom Index

Freedom score	Freedom Status
5.5 - 7.0	Free
3.0 - 5.0	Partly Free
0.0 - 2.5	Not Free

⁴¹ Freedom House website: <http://www.freedomhouse.org/template.cfm?page=277>

Figure 1



The table shows that between 1972 and 2001 there has been a positive step towards greater freedom. Whilst non oil producers have made more progress in terms of political and civil liberties and can as a group be categorised as 'Partly Free', oil states have themselves made considerable progress from their almost entirely dictatorial (and colonial in the case of Angola) position in 1972. Though the oil producers remain in the 'Not Free' category, they have made significant improvements in terms of overall levels of freedom.

Thus table one shows that the oil windfall of the 21st century has been received by states which have improved their political environment compared to the more authoritarian states of the early 1970's. The region in general has taken positive steps to improve the political environment, and the oil producers are no exception to this wider trend.

Figure 1.1 shows in greater detail the level of change for each oil producer in the region. The table highlights the point that the majority of states have improved their political environment since the outset of the previous oil boom. Only Sudan and Cameroon have regressed, and Equatorial Guinea remains unchanged.

Figure 1.1

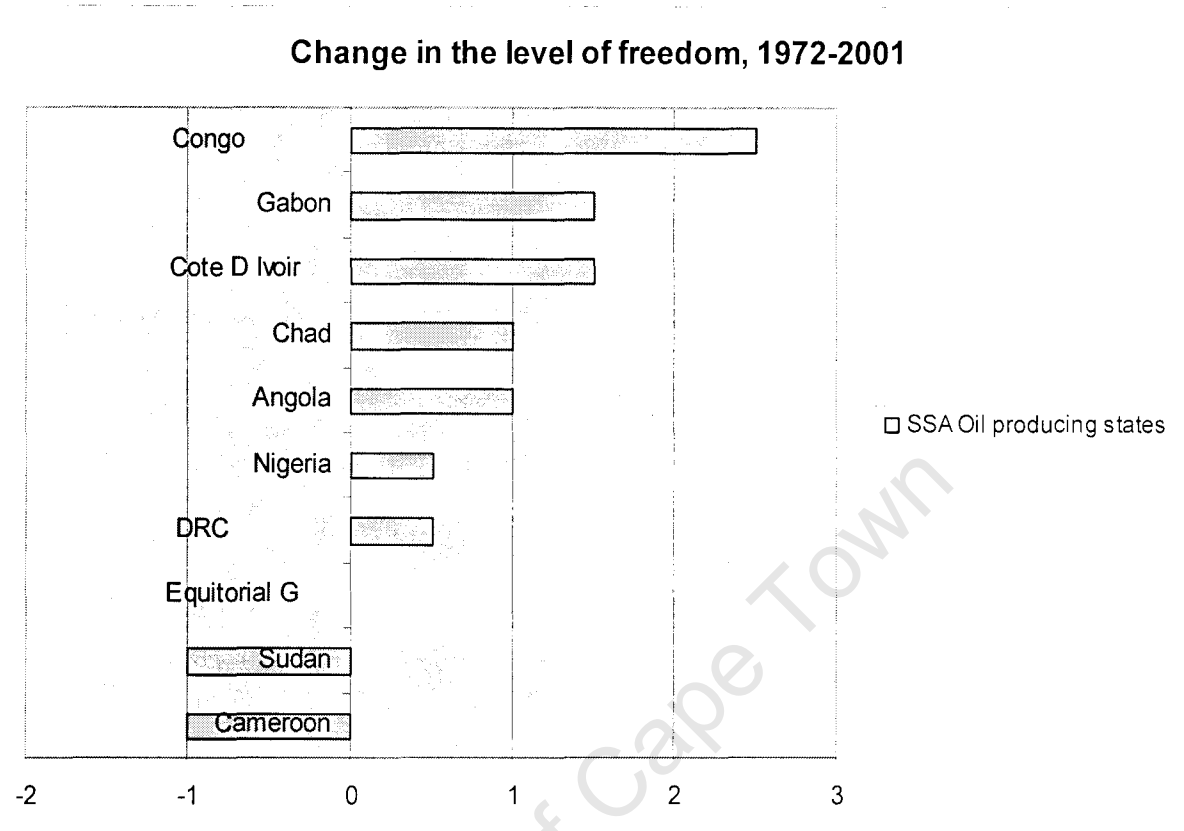


Figure 1.2 Shows the absolute level of freedom for oil producing countries in 1972. Using the Freedom Index, the figure shows that only two of the ten selected countries would qualify as 'Partly Free' and they would do so at the most minimal level. The rest of the states fall into the 'Not Free' category.

Figure 1.3 Shows the absolute score for each of the oil producing countries in 2001. According to the Freedom House Index four of these states would now be characterized as 'Partly Free' whilst the remainder of the states would fall into the 'Not Free' category.

Figure 1.2

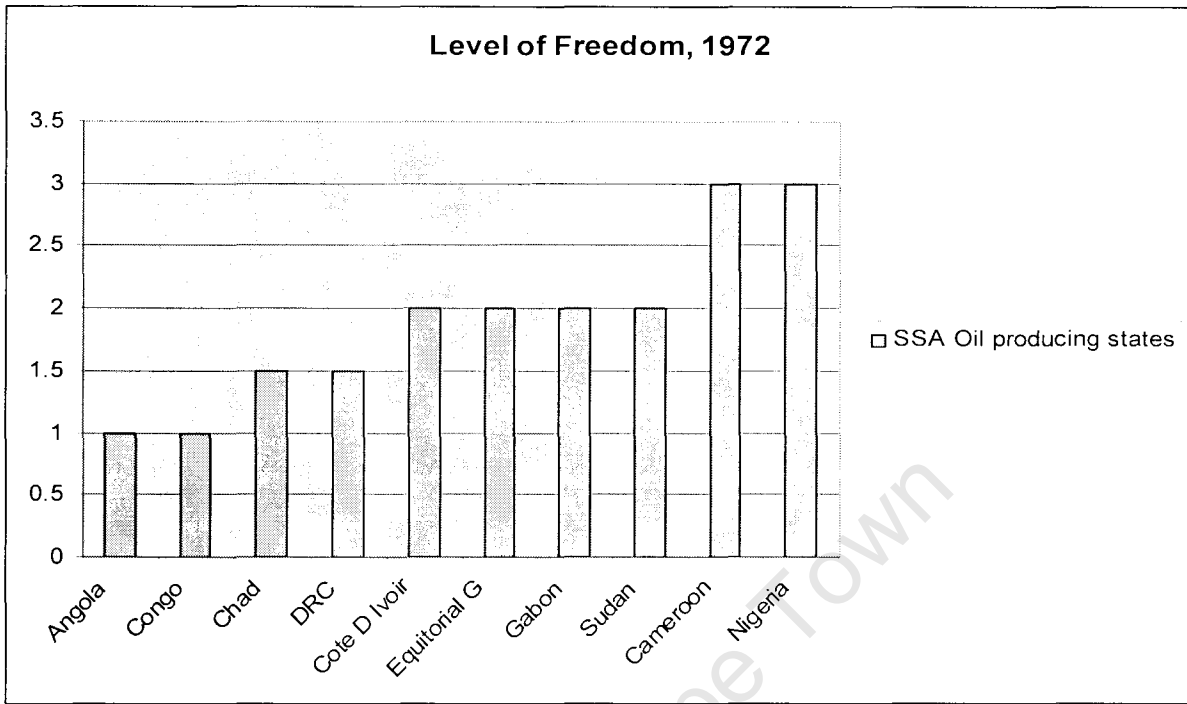
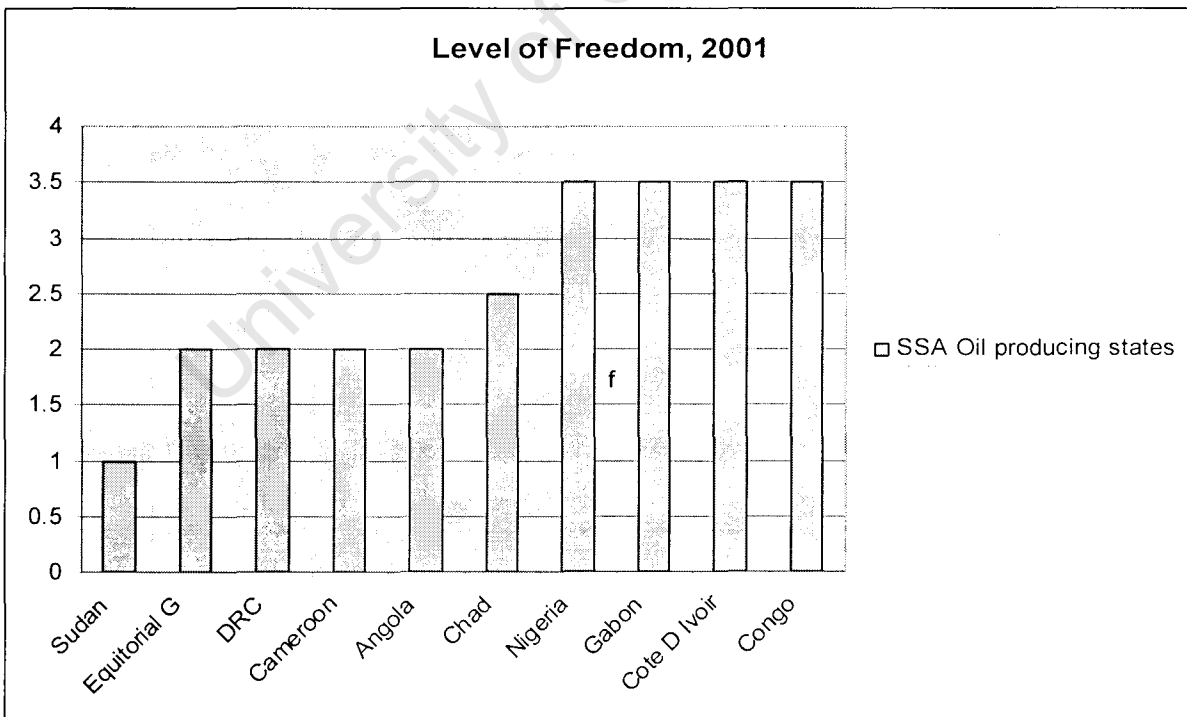


Figure 1.3



Both figures highlight the significant progress that has been made in terms of the regions oil producers becoming less authoritarian, and attaining a greater degree of democracy and freedom. The number of 'Partly Free' countries has doubled and there has been a general improvement amongst the other states, which is

indicative of a region wide trend towards greater freedom and democracy. In effect Sub-Saharan oil producers have greatly improved their level of freedom between the two periods and thus increased the possibility that oil revenue will be better managed.

Improvements in the Oil Industry

In terms of democratic transition Sub-Saharan oil states have taken a major step forward, and the reasons for this advance are not just due to wider factors such as the 'third wave' of democracy. There has also been a considerable effort amongst all the major international players involved in the oil industry to improve business practice and undertake important policy reforms.

The dismal record of Africa's oil producing states throughout the 1970's and 1980's led to growing criticism from Non Governmental Organisations (NGO's), development experts, and people living in oil exporting areas, who became dismayed at the way oil wealth was being squandered. The result of this outcry was that starting in the mid 1990's 'there has been unprecedented pressure upon all major international players to improve their performance in regard to government practice and the use of oil wealth'.⁴²

International Financial Institutions (IFI's) like that of the World Bank and International Monetary Fund (IMF), have undertaken considerable measures to ensure that petro states in Africa improve their political environment and undertake sustainable development strategies. In 2002 for example, the World Bank undertook the 'Extractive Industries Review' (EIR) with the goal of overcoming some of the most damaging effects of resource dependence. The result of this review has led to new political initiatives, the central feature of which is that states must promote oil revenue transparency and improve government

⁴² Karl, Terry Lynn and Ian, Gary, *Bottom of the Barrel: Africa's Oil Boom and the Poor*, (Report for the Catholic Relief Services, June, 2003) p42.

practice.⁴³ One of the major incentives for states to adhere to these initiatives is that the bank has within its powers the ability to considerably reduce levels of debt repayment. It is just such an incentive that has encouraged African states like Nigeria to undertake major political and economic reforms.⁴⁴ Indeed the actions of such bodies as the World Bank and also the Paris Club⁴⁵, have ensured that Nigeria's level of foreign debt has been reduced by a whole third. The wiping out of such a large debt though was conditional upon Nigeria undertaking a major reform programme, which it did indeed undertake in 2004. The programme of reform initiated in this period has made positive inroads into tackling the most damaging aspects of the resource curse and has encouraged a more responsible use of oil revenue.⁴⁶ Thus pressure and incentives from the IFI's can be seen as having a direct impact upon the domestic sphere within the oil producing states, and serves as an illustrative point of positive change.

The IMF has supported this more proactive stance by 'the promotion of greater transparency and in some cases, the establishment of special funds to manage petroleum revenues'. The external pressure exerted by these institutions can be measured in oil producing countries such as Cameroon, where 'the state is obliged to provide monthly data on oil exports, prices, and government revenue to the IMF, a demand to which it has complied'.⁴⁷ Thus the IMF, like the World Bank, has been able to exert considerable pressure upon Sub-Saharan oil states through fiscal incentives. The result has so far been positive and resulted in countries like Cameroon and Nigeria, becoming more transparent and responsible in terms of how they manage their oil wealth.

⁴³ Ibid, p50.

⁴⁴ Taken from the World Bank Website, March 29, 2004:
<http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20185358~pagePK:64257043~piPK:437376~theSitePK:4607,00.html>

⁴⁵ The Paris Club is an informal group of official creditors whose role is to find coordinated and sustainable solutions to the payment difficulties experienced by debtor countries. As debtor countries undertake reforms to stabilize and restore their macroeconomic and financial situation, Paris Club creditors provide an appropriate debt treatment.

⁴⁶ For a detailed outline of Nigeria's reform programme, see chapter 7.

⁴⁷ IMF Surveillance: A Factsheet, April 2003.

As well as the major international financial institutions, oil companies are themselves taking increased measures to reverse the negative effects of oil upon producer states. Companies such as BP have undertaken 'transparency initiatives' which undermine the ability of corrupt states to squander their wealth through unlawful practice. The tough stance taken by BP towards the discrepancies of the Angolan government, led in 2002, to a major breakdown in relations between the two protagonists.⁴⁸ Whilst Angola remains unrepentant (and has become increasingly reliant upon exports to the Chinese market) this episode highlights the degree to which major oil companies are willing to confront bad practice by producer states. Such confrontation between a major oil company and African oil producer would have been unheard of in previous decades.

Central to the positive actions that are being undertaken by international organisations and oil companies is the increased role of civil society groups pressing for important reforms. For example, 'at the Africa-wide consultation for the EIR in January 2003, African groups issued a joint declaration calling for the suspension of World Bank financing, and support for oil and mining, until, among other conditions, revenues from projects were disclosed to citizens'⁴⁹ As civil society groups have become more emboldened, organised and resolute in their actions, the international community has had to take a tougher stance against oil producing states. The result of which is that states find it much harder (though not impossible) to undertake the same types of irresponsible political and economic actions that were the hallmark of their predecessors during the 1970's oil boom.

Perhaps the best example of the positive changes that have occurred amongst the major players involved in the industry is the 'Chad-Cameroon oil experiment'. The oil and pipeline project 'is the most significant and most closely watched experiment, designed to change the pattern of the oil curse through targeted use of oil revenue. Widely touted as a model for other experimenting countries, this high risk \$3.7 billion project involves ExxonMobil, Chevron, The World Bank, the

⁴⁸ Cauvin, Henri, *IMF Skewers Corruption in Angola*, New York Times, Nov. 30, 2002

⁴⁹ Karl, (2003), p53.

governments of Chad and Cameroon and other actors. The project will generate many billions of dollars for the governments of Chad and Cameroon just in its first decade'.⁵⁰

The project is unique in the fact that the major investors, like the World Bank, have obliged the governments of both Chad and Cameroon to undertake substantial legal changes that are hoped will ensure oil revenue is used productively. The 'new management revenue law' was established in 2002 to ensure that oil wealth is used to build and support key state and financial institutions. The law stipulates that 80 percent of petrodollar revenues will be devoted to expenditures in five priority sectors (education, health, rural development, infrastructure, and water and environmental resources), five percent to affected communities, and the rest to be allocated according to specific formula'.⁵¹

The new pipeline marks an important development in the relationship between oil producers and international actors in Sub-Saharan Africa. Both parties are now more aware of the obligations that they must undertake in terms of ensuring that the worst aspects of the resource curse are avoided, and the international community has begun to take direct steps, relevant to reducing the worst elements of oil boom policy-making. Though there is still a long way to go, there have been major improvements since the last oil boom of the 1970's; the most important of which is the fact that oil producing states have improved their business practice, and they have done so with considerable pressure from the wider international community and specific actors within the oil industry itself. Coupled to this progress is the fact that states have become less authoritarian, and are showing increased levels of freedom.

⁵⁰ Ibid, p 68.

⁵¹ Loi No. 001/PR/99. Text of the law can be found at www.ccrsp.td

Conclusion

The importance of the political environment as a factor that determines how oil wealth is allocated is considerable. Having in place the right environment (whether it is democratic or authoritarian, free or unfree) is key to overcoming the worst aspects of the resource curse, and establishing long term economic growth. That the political environment and the oil industry itself has improved across Sub-Saharan Africa since the 1970's is a certainty; given this, one could say that there is very good reason to reconsider the common wisdom of the impact of oil booms (based as they are upon the experience of states in the 1970's and early 1980's) with more recent evidence.

Thus in chapter six, I actually assess whether governments during the 21st century boom have indeed broken the negative cycle associated with the resource curse; and I answer the key question, 'have the positive trends (which I have highlighted) in the political sphere and within the oil industry, resulted in a better use of oil revenue in the contemporary period?'

Chapter 5:

Africa's Recent Oil Boom

The aim of this chapter is to highlight the fact that in recent years Africa has experienced a major oil boom. I wish to make clear those Sub-Saharan states which have benefited most from the recent 'bonanza', and the degree to which the whole region has experienced growing levels of oil related wealth. In this way I hope to lay the foundations for the following chapter, which seeks to explain how these states have allocated their new found wealth, and how this will effect the prospects of future economic development. To the question of 'whether Sub-Saharan Africa has experienced an oil boom in the recent past?' the answer is best summarised by the facts that there have been enormous levels of investment in this period, there has been a dramatic increase in levels of production, and for a five year period the price of oil was sustained at an extremely high level. Taken together, these factors highlight the clear answer, that in recent years Sub-Saharan Africa has experienced a considerable oil bonanza.

The following chapter is broken down into two parts; the first outlines the increased international focus upon the region, the raised levels of investment and the growing levels of oil production. The second section focus's upon the dramatic increase in the price of oil leading up to its sudden decline in 2008, and assesses how great a volume of oil revenue actually accrued to the oil producers of Sub-Saharan Africa.

Increased Levels of Investment and Production

Beginning in the mid 1990's, there has been a dramatic rise in the number of international actors who have sought out African oil as a means to meet growing demands, as well as the prospect of making huge profits. The increased focus upon the region has been based upon three broad factors; the first was that major discoveries in the area of the Gulf of Guinea made clear the point that there was

enormous offshore potential. The second major factor was essentially political in nature, the U.S. looking to lessen its reliance upon the Middle East as its main source of oil, (due to the changing political climate and in light of the 9/11 terrorist attacks) focused upon Sub-Saharan Africa as a potential base from which to diversify international production. The final factor was the growth of major economies in the world such as China and India. These new players, seeking to secure those raw materials, such as oil, that would allow continued economic growth, directed considerable political and economic resources to the region. Sub-Saharan Africa for so long on the margins of strategic considerations began to attract the attentions of powerful international actors who sought to utilise the economic potential of the region. These factors taken together placed Africa's oil producing states at the centre of international designs and global policy. The result was an incredible growth in foreign investment, dramatically increased levels of oil production, and states (such as Equatorial Guinea and Chad) that previously had no connection with oil, suddenly becoming major producers.

Writing in 2002, the Catholic Relief Services, conservatively estimated that Sub-Saharan governments would receive over \$200 billion in oil revenues over the following decade. Such a sum would constitute, 'the largest and most concentrated influx of revenue in African history'.⁵² This startling estimation was made prior to the dramatic increase in oil prices, so one can only imagine the actual sums that have been drawn into the region. Taking Angola as an example of the changes that have occurred in the region; 'between 1995 and 1999, Angola increased proven reserves by 600 percent, more than any country in the world during that period. Other countries such as Sao Tome and Principe recently discovered more than four billion barrels of oil in its territorial waters'.⁵³ With such discoveries taking place and the prospect that many more 'fields' were (and still are) waiting to be discovered, it is little wonder that West Africa has been termed as the 'New Eldorado', and is generally viewed by the oil industry as the world's

⁵² Karl, Terry Lynn, *Bottom of the Barrel: Africa's Oil Boom and the Poor* (Catholic Relief Services, June 2003) p5

⁵³ Anderson, Jon, 'Our New Best Friend: Who Needs Saudi Arabia When You've got Sao Tome?' (The New Yorker, October 7, 2002) p74-83.

premier hotspot, soon to become the leading deepwater offshore oil production centre'.⁵⁴

With such enormous potential in the region, it is little wonder that levels of investment have been continually rising since the mid 1990's. 'About \$52 billion will be invested in deepwater African fields by 2010 with approximately 32 percent coming from the U.S. According to industry sources, the Gulf of Guinea region received the world's largest amount of offshore hydrocarbon investment in 2005'⁵⁵

Adding to this, and helping to drive forward this high level of investment, has been an intense rivalry between participating actors to secure exploration and production rights.⁵⁶ The rivalry between French and U.S. Oil companies typifies the clash between major oil companies in the region. The French who have a long history in the region have suddenly been faced in recent years by the incursion of large U.S. Companies such as ChevronTexaco and ExxonMobil. ChevronTexaco announced in 2002 that it had invested \$5 billion in the past five years in African oil, and would spend \$20 billion more in the next five years. ExxonMobil intends to spend \$25 billion across Africa from 2002 to 2010.⁵⁷ The stakes of the game have been raised by the involvement of these new actors, which has led to years of fast growth, big incentives for local governments and enormous levels of investment. Following close on the heels of these 'majors', have been national governments which have sought to secure for their companies the best possible terms from African governments.

The role of the U.S in West Africa over the last ten years has grown enormously, and typifies the trend of vying for political influence in the region. Driven on by matters of national security and economic concerns, the focus on Sub-Saharan Africa as a source of 'safe' mineral deposits, has led to state sponsored initiatives in the region. 'In a global environment shaped by fears of terrorism and instability

⁵⁴ Scheiber, Norm, *Where the Oil Is* (New York Magazine, November 10th, 2002) p26-28.

⁵⁵ *The Offshore West Africa Report 2002-2005*, Canterbury, U.K.: Douglas Westwood Ltd.

⁵⁶ Karl, (2003) p19.

⁵⁷ The Economist, 'Sub-Saharan African Oil: Black Gold' (October 24th, 2002)

in the Middle East, Africa is suddenly no longer considered a strategic backwater and a major reason is oil'.⁵⁸ At present the region counts for 21 percent of oil imports into the U.S and this figure is set to rise to 25 percent by 2010. The growing importance of Africa's oil is not a consideration of the U.S alone; the expanding economies of states such as India and especially China, have undertaken bold steps to establish themselves in the region.

China now receives about one-third of its oil imports from Africa and this figure is set to rise as Beijing seeks further consent for further exploration and increased production. Using diplomacy, trade deals, debt forgiveness and aid packages, the Chinese government has eagerly pursued a forward and open policy to lure governments into advantageous agreements that will secure a slice of Africa's oil for the Chinese state.⁵⁹ The Indian government has also undertaken a similar policy, by promising large incentives to African states, in the hope of securing a foothold within the region. 'India is offering West African nations billions of dollars towards power or infrastructure projects in exchange for oil exploration rights and supplies. An example of this new Indian position, is expressed by a recent '\$6 billion infrastructure deal agreed in Nigeria by ONGC Mittal Energy'⁶⁰ (An Indian state run metals and energy company).

The impact of such international focus and investment on levels of production have been enormous, in 2002 overall oil production in the region was around 3.8 million barrels per day (bpd), in 2008 that figure had jumped to 6.8 million bpd. The main increases have been concentrated in Nigeria, Angola, Chad and Equatorial Guinea.⁶¹ 'The U.S. Government's Energy Information Administration

⁵⁸ Karl (2003), p18

⁵⁹ Hanson, Stephanie, *China, Africa and Oil*, (Council of Foreign Relations, June 6th, 2008) http://www.cfr.org/publication/9557/china_africa_and_oil.html?breadcrumb=%2Fbios%2F12300%2Fstephanie_hanson

⁶⁰ BBC News Site, *Indian Cash eyes West Africa Oil* (Thursday, 24th November, 2005) <http://news.bbc.co.uk/1/hi/business/4465962.stm>

⁶¹ Presentation by Kepes, Jerry, Managing Director, Petroleum Finance Corporation, to Centre for Strategic and International Studies, 'US-Africa Security Interests' Senate Dirksen Building, December 5, 2002.

(EIA) conservatively estimates that the region will be producing nine million bpd by 2030'.⁶²

That Sub-Saharan oil states have, and still are, experiencing an unprecedented boom period in terms of foreign investment, increased production, and a greater international focus upon their resources, cannot be denied. The size of the oil discoveries in the area and the potential wealth generated through these discoveries has attracted a multitude of actors into the region, and brought Sub-Saharan Africa to the forefront of global economic concerns. New oil states such as Chad have risen in this era, and countries such as Sao Tome and Principe will, in the foreseeable future join the exclusive club of oil producers. The older and more established oil states of Nigeria and Angola, have through new discoveries, more than doubled and then quadrupled their potential oil reserves, and amongst all these actors whether old or new, global actors have been injecting such levels of wealth, that states have been awash with oil related funds.

Coupled to this dramatic increase in investment and levels of production, oil prices have, until very recently, been at an extremely high level.

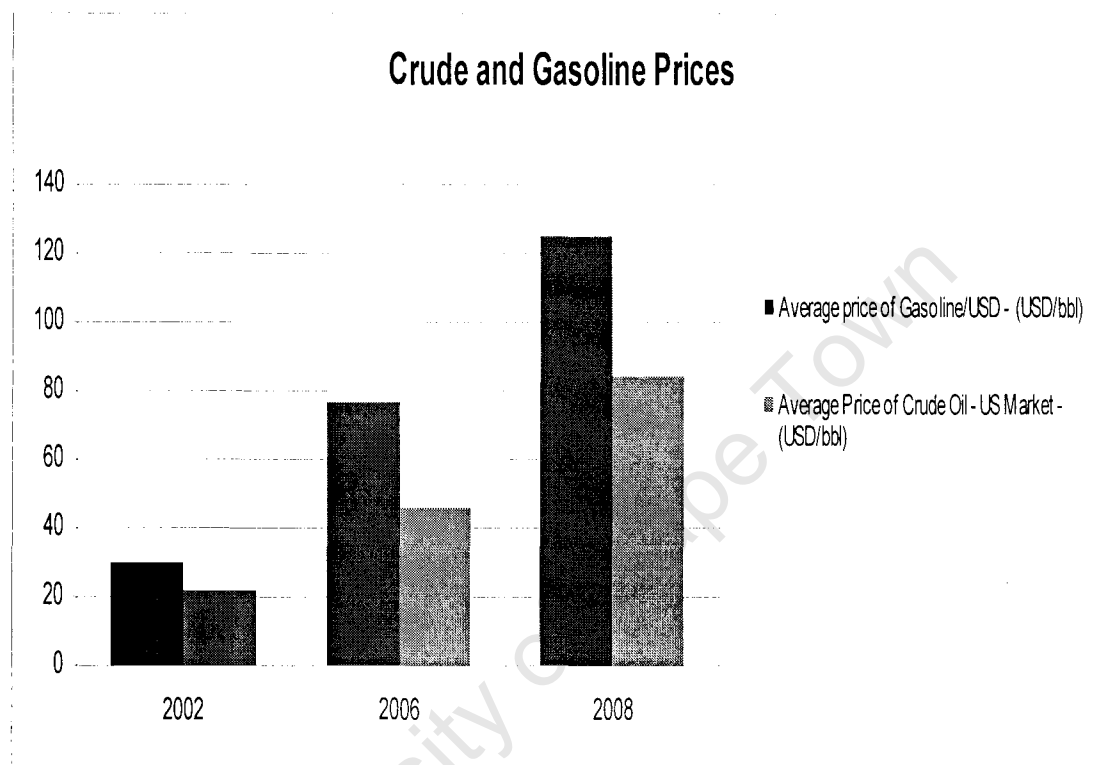
Oil Statistics

From 2002, leading up to 2008, the price of oil more than quadrupled. The oil producing states of Sub-Saharan Africa experienced a bonanza of petro-dollars that had not been experienced since the 1970's. The average price of crude oil jumped from twenty dollars in 2002, to over forty dollars in 2006, and then peaked at over eighty dollars in 2008. (See figure 2) Though the boom period was to come

⁶² US Department of Energy, Energy Information Administration, International Energy Outlook 2002.

to a sudden halt towards the end of 2008, the region had experienced over five years of inflated oil prices.

Figure 2⁶³



To measure the economic impact that this surge in prices had upon the oil states, I have measured the amount of oil revenue (that is the average of total revenue for oil exports per country, per year) between 2002-2006. The figures show the amounts of revenue that have accrued to these countries in the early and mid bonanza period, and they also show those states which have benefited most from the period.⁶⁴ (See figure 2.1) Due to increased levels of production, tapping into new oil reservoirs and the rapid rise in oil prices, countries such as Angola and Nigeria have reaped enormous profits from the boom period. In smaller, less

⁶³ Figures were taken from the OECD statistics website. The information was supplied to the OECD by the Energy Information Administration:

http://www.oecd.org/statsportal/0,3352,en_2825_293564_1_1_1_1_1,00.html

⁶⁴ Statistics from 2006-2008 are as yet unobtainable for all Sub-Saharan African states

populace countries such as Chad, Equatorial Guinea and Congo Brazzaville, the impact has been no less dramatic.

Figure 2.1⁶⁵

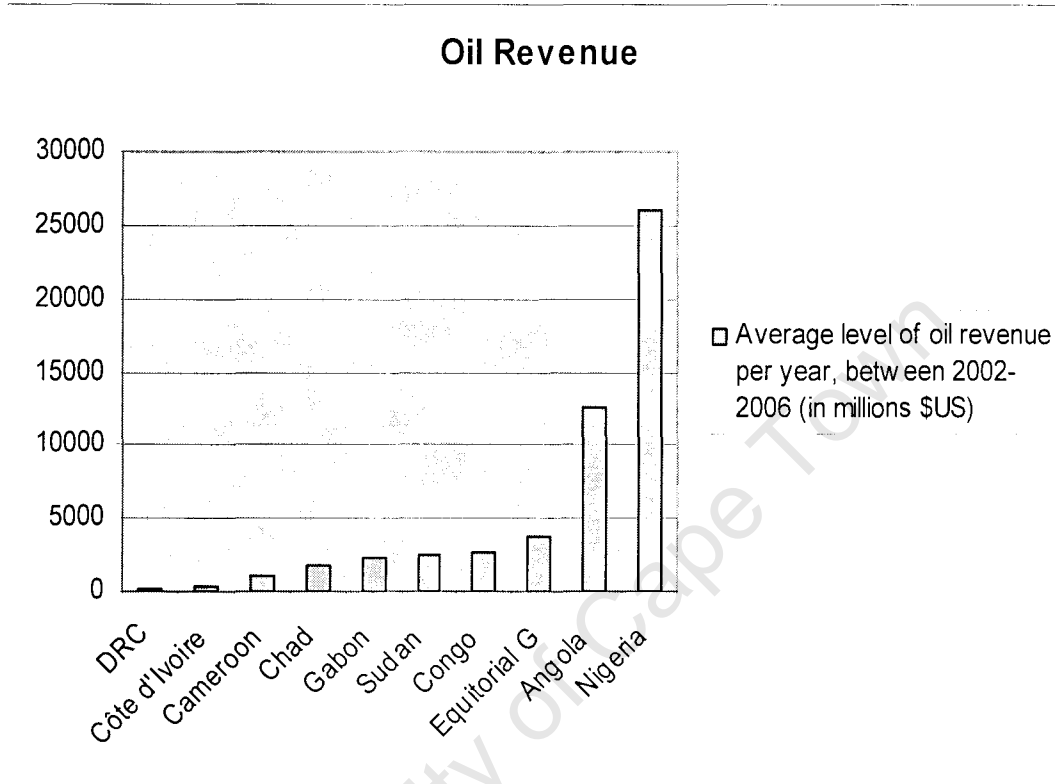
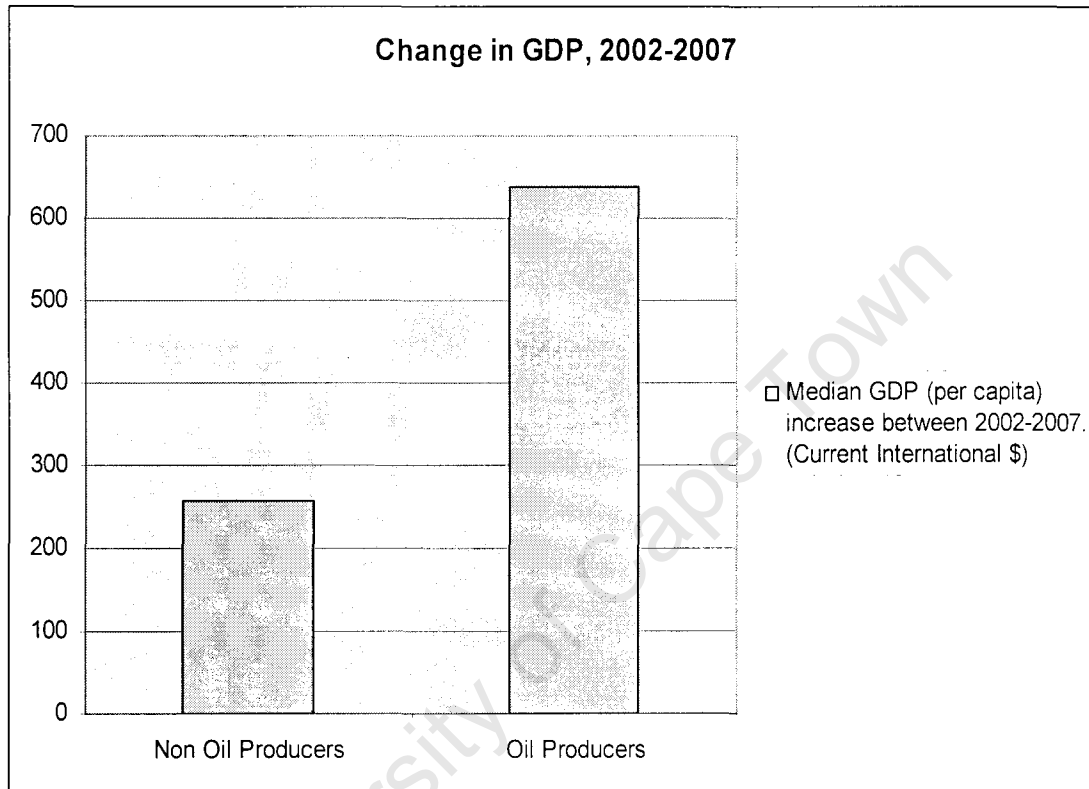


Figure 2.2 shows the median increase in GDP (per capita) between non oil producers and oil producers across the region between 2002-2007. The figure highlights the point that the increase in total revenue for oil producers has had clear results in terms of raised levels of GDP. That oil states are generating a greater amount of wealth compared to non-producers in the region is clear to see. The increase in oil revenue, as one would expect to find during a boom period, has resulted in a greater divergence between the oil producers and non-producers.

⁶⁵ The amount of yearly oil exported from each Sub-Saharan country is listed on the EIA website. From these figures I was able to calculate, (with the average price of crude oil in the given year) the total sum of money accruing to each country, by year, from crude oil exports.
http://tonto.eia.doe.gov/country/country_energy_data.cfm?fips=EK

On average GDP amongst oil producers has increased more than twofold, compared to the non producers.

Figure 2.2



The impact of the oil bonanza is made even more apparent when one considers the level of economic reliance states place upon their oil exports. It is often the case that oil exports are the central foundation upon which the export economy is based. Figure's 2.3 and 2.4 highlight this point, showing how high a percentage of total exports are based upon crude oil. The figures show that for the majority of producers, oil is the single most important export, indeed for countries such as Equatorial Guinea, Angola, Nigeria and Chad, external trade is based almost entirely upon the single commodity. Within such singular economies as these, based as they are solely upon the export of oil, the impact of such a bonanza period is considerable. The ability of the state to realise long-term economic growth is tied very closely to the levels of oil revenue, and how the state allocates these funds.

Figure 2.3⁶⁶

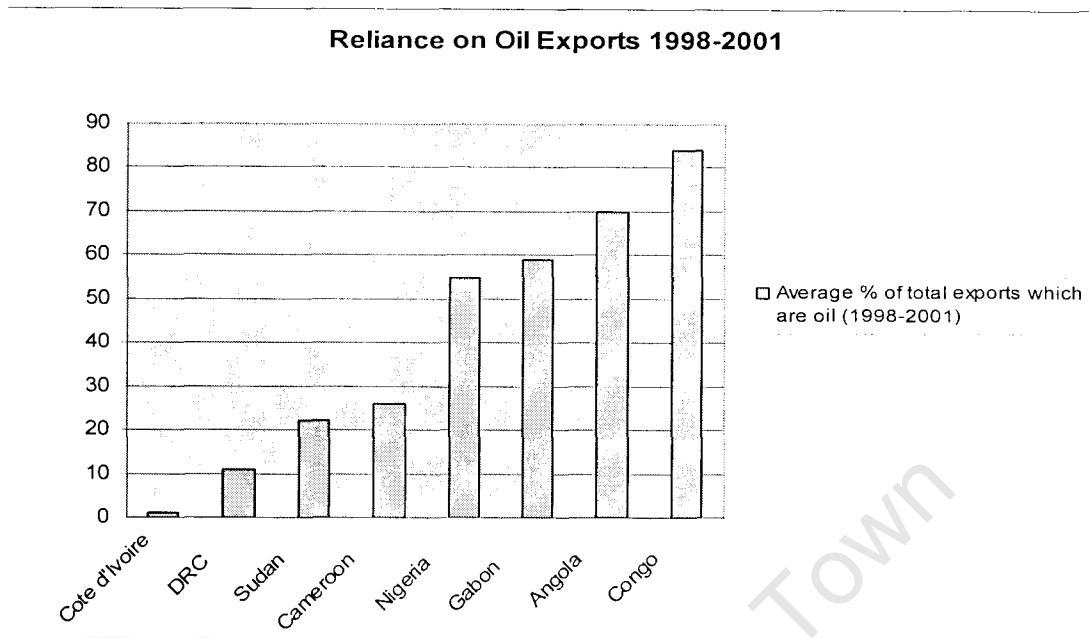
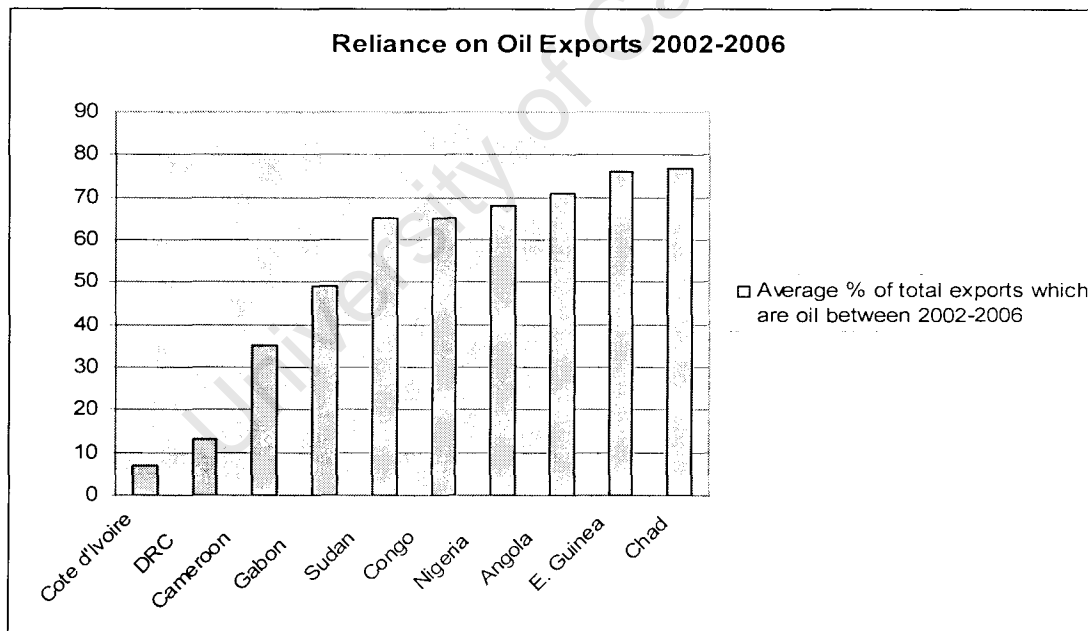


Figure 2.4

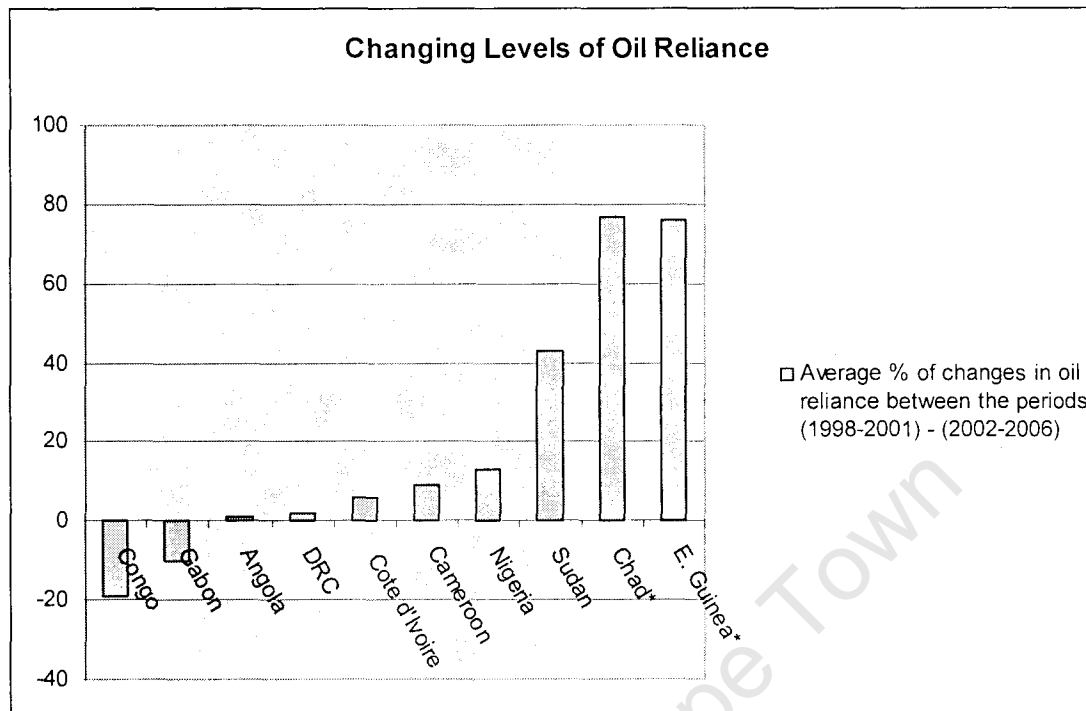


⁶⁶ To calculate the percentage of total exports which are oil, I first collected data from the World Bank, World Development Indicators which gave the total yearly income for all exports per country, per year. I then compared these figures to the data I had collected on the total yearly income from oil exports, and calculated what percentage of total export revenue was generated from oil.

World Bank Development website:

<http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/>

Figure 2.5



Figure's 2.3 2.4 and 2.5 also show the degree to which the majority of oil states have become increasingly reliant upon exports of oil in the recent price rise period. Figure 2.5 clearly demonstrates, that for the majority of states the rise in oil prices and increased oil production across the region has meant that their economies have been even more greatly impacted upon by the surge in oil revenue. As the price of oil increased and production was stepped up from 2002, so this correlated directly into a greater percentage of total country exports becoming based upon oil. Only the Republic of the Congo and Gabon have shown a decrease in oil reliance between the two periods, and this is due to the fact that these countries are experiencing depleted oil reserves and thus a fall in production.⁶⁷ In countries such as Chad and Equatorial Guinea, the impact of recent oil discoveries and the rise in oil prices has been enormous; transforming their economies, that previously had had no oil revenue, to economies in which nearly 70 percent of total exports now come from that single commodity.

⁶⁷ For information on the economy of Gabon, see: <https://www.cia.gov/library/publications/the-world-factbook/geos/gb.html>

For information regarding economy of Republic of the Congo, see: <https://www.cia.gov/library/publications/the-world-factbook/geos/cf.html>

Conclusion

Building steadily since the mid 1990's, Sub-Saharan oil states have been at the centre of international competition to secure precious commodities in the region. New discoveries of oil, the introduction of new actors such as China, India and the U.S in the region, and the changing international political climate, have resulted in an unprecedented period of growth and investment. The oil states of the region have been at the forefront of this regional trend and have reaped the greatest profits. Coupled with these developments was a boom in oil prices, which though reduced now, heralded a five year period in which petro-dollars flowed into the region.

That Sub-Saharan oil states have experienced an oil boom is undeniable, the questions which I wish to tackle in the next chapter, is how this new wealth has been allocated and 'what are the prospects that these increased funds will spur on future economic development?' Will these oil states repeat the same boom to bust cycle that followed the price bonanza of the 1970's and early 1980's; or have patterns of allocation changed so that long term economic growth can be made a reality?

Chapter 6

Resource Allocation

Part I. Resource led development: Past failures and Future Possibilities.

Previous chapters have been concerned with highlighting the fact that there has been positive change within Sub-Saharan Africa, in regard to the political environment, and that within the international community there has been an increased focus upon better governance and more responsible use of resource wealth. In this chapter I assess how increased oil funds have been allocated in the past and present, and assess whether improvements in the domestic political environment, and international community, have indeed resulted in a more positive use of resource wealth. The central question which I wish to answer, is whether oil states have broken free from the disastrous policies of their predecessors, and improved their prospects of long-term economic growth?

The structure of this chapter is broken down into two parts; In part I, I outline the broad conclusions regarding the ways in which oil money was allocated during the previous oil boom of the 1970's, and the disastrous impact this had upon long term development. Within this first section I also assess the literature around the subject, and draw up a concise set of policy recommendations, that outline how oil revenue should be allocated if sustainable economic growth is to be attained. In part II, I outline my empirical results, which show those areas in which oil states have allocated their increased wealth in the current era, and the amounts that they have placed there.

The evidence of my empirical findings is conclusive, it shows that these states have broken from the disastrous policies which were undertaken by their predecessors, and have actually undertaken many of those key policy recommendations prescribed by development analysts.

The findings support my central hypothesis, that improvements in the international and domestic sphere have resulted in a considerable improvement in

the way that oil states allocate their wealth; a point that holds out the prospect that these countries will not follow the same boom to bust cycle of their predecessors, and can actually move beyond the destructive cycle of the resource curse.

Resource Allocation in the 1970's and its consequences.

Resource allocation amongst Africa's oil producers in the 1970's was characterized by rapid spending on large public projects, heavy borrowing from abroad, and huge subsidies to struggling sectors. The consequence of these endeavours was that most African states by the beginning of the 1980's were saddled with huge debts, had much greater dependence upon the oil industry alone, and there was considerable decline in areas such as agriculture and manufacturing. The central problem which caused this predicament was based upon the fact that states undertook 'big spend' policies' (that is they undertook a rapid programme of spending that was beyond their means, both in terms of financing and application). The reasons why this policy was so problematic and destructive to long term development are now discussed.

Spending Big

Alan Gelb in his study of six developing oil producing states in the 1970's highlights common characteristics amongst the group. He found that all these states faced considerable political pressure to spend quickly, so that they could relieve public pressure to transfer wealth into projects that would benefit the masses. For these reasons, enormous sums of money were funnelled into the public sector and heavy industry. Enormous programs of spending were a common characteristic of the majority of producer states in the period. In Nigeria for example, the government undertook ambitious schemes to introduce universal primary and secondary education across the country. Major industrial (iron and steel) projects

were set-up, and vast sums were spent on improving infrastructure.⁶⁸ Whilst in Congo Brazzaville, the states sizeable investment budget was used to create dozens of State-owned enterprises and parastatals, and in terms of public spending, a massive programme in school building was undertaken. This resulted in school enrolment growing from 280,000 in 1971, to 700,000 in 1986.⁶⁹ In Gabon, the 'big spend' policy reached new heights, the pinnacle of which was the TransGabonais railway, which is estimated to have cost over \$3 billion. The state also made an unsuccessful bid to build a nuclear power station, and throughout the 1970's the country held the title of 'world's largest per capita importer of champagne'.⁷⁰ The oil boom effectively created a common economic doctrine amongst the oil producers, which was to spend as much as possible, as quickly as possible.

Though on the surface these initiatives, such as building up public services and industry, looked as if they might benefit long term development, in fact they were to cause a stifling burden upon the economy in the years to come. The problem with these 'big spend' policies, was that essentially they were unaffordable, unsustainable, poorly implemented and funds were often misallocated. In effect, states undertook enormous public projects that were doomed to failure.

Bad Investments and Unsustainable projects

Many states seeking areas in which petro-dollars could be quickly invested (and thus satisfy political demands) undertook enormous industrial and public projects that they hoped would help diversify the economy, and project the state upon wider industrial led economic growth. Thus, as oil revenues grew in size, so did the number of industrial and public projects. Unfortunately, the majority of these projects were undertaken against the recommendations of feasibility studies,

⁶⁸ Gelb, Alan H, *Oil Windfalls: Blessing or Curse?* A world Bank Research Publication (Oxford University Press, 1988). P105

⁶⁹ Clark, John, '*Petro-Politics in Congo*, *Journal of Democracy*', Volume 8, Number 3, July 1997, p66

⁷⁰ Karl, Terry Lynn and Ian Gary, *Bottom of the Barrel: Africa's Oil Boom and the Poor*, Report for the Catholic Relief Services, June, 2003. p34.

which foresaw the difficulties with establishing such capital intensive programs upon a resource income in which value was extremely volatile. The other major factor that undermined feasibility was that the states themselves did not have the means to implement such grand economic strategies. In Congo-Brazzaville for example, 'Resource Based Industrialization' (RBI) was hampered by the fact that there was 'an inadequate country (market) size, there was poor macroeconomic management, and there was an absence of efficient enterprises with which to establish and run RBI'⁷¹ New manufacturers were also faced with the prospect of stiff opposition on the international stage. Gelb explains 'that plants in the oil exporting countries were forced to sell on residual world markets, where price was set by the globally most efficient or most heavily subsidized competitors.'⁷² In such an environment they had little chance of success. In effect many of the projects were undertaken with little hope of being completed, and if they were completed they would be unable to compete with global competitors.

These large macro-projects were also technically demanding, and had a greater tendency to overrun initial cost and time budgets. By 1980 one third of the largest projects had experienced cost overruns of 109 percent. Delays of between one and two years plagued half the projects; and a further 25 percent experienced delays of three to four years.⁷³ A good example of this situation, is the 'Coraf oil Refinery' at Pointe Noire. The refinery was begun in 1979 and was meant to vastly increase the level of oil revenue; unfortunately the project was plagued by technical problems, misallocation of funds and a lack of logistical expertise. Coupled to the fact that there was complete mismanagement of the project, there also existed outright corruption, which was a further drain on resources. It is thought that President Yhombi embezzled over \$50 million during the period of construction. In effect there was a complete lack of project implementation, the

⁷¹ Ibid, p66

⁷² Gelb, (1988) p113

⁷³ Ibid, p109

result of which was that 'the refinery has never operated at more than half its capacity; instead of a spur to the growth it has become a drain on the economy'.⁷⁴

When the price of oil plummeted in the early 1980's it marked the end of many of these large initiatives which were mostly unfinished, or in need of considerable subsidies. The enormous spending spree which encompassed industry, schools, infrastructure and hospitals soaked up vast amounts of oil revenue and produced no economic benefits in return. They were ultimately unsustainable and an unmitigated disaster. As the world economy began to slow, schools and hospitals were left unfinished, or later abandoned, and newly built roads and industrial centres could not be maintained and soon fell into disrepair.

It seems clear with hindsight, that undertaking such projects, based as they were upon the hope that oil prices remained high, was a disastrous use of the resource funds. Gelb highlights this mistake, explaining that 'The exporters chose to convert enormous investable surpluses into fixed assets in a period when the range of uncertainty over key global economic variables and structural relationships was unusually large'⁷⁵

Coupled to this point, was the fact that their existed little capability within the states themselves to successfully implement such far-reaching goals. Poor management, corruption, bad investments and a lack of technical and logistical capability helped to ensure that the 'big spend' policy of the period would end in disaster. The most harmful effect of this period would be the enormous debt that was accumulated by producer states.

National Debt and the Legacy of the Oil boom

A major consequence of the economic policies undertaken by developing countries, was that they came to rely to a greater extent upon borrowing from abroad to maintain the large projects that they had undertaken. Major lenders,

⁷⁴ Clark, (1997), p66

⁷⁵ Ibid, p117

such as the IMF and large multi-nationals, were happy to lend vast sums to developing producer states, based upon the agreement that loans would be backed by surplus oil revenue. For example the government of Congo-Brazzaville turned repeatedly to 'Elf-Congo to finance development projects and make up for chronic budget deficits. As a result a large portion of Congo's future oil earnings were mortgaged away'.⁷⁶ Similarly, the IMF came to the rescue of Gabon as early as 1977, when the governments spending on a lavish Organisation for African Unity (OAU) summit literally bankrupted the state. It continued to borrow throughout the 1980's, producing a crippling debt burden.⁷⁷

Thus the oil boom of the 1970's had a twofold effect upon policymakers, it encouraged them to undertake ambitious public spending, and they were encouraged to borrow much larger sums of money from abroad that would otherwise have not been possible. The sudden severity of the economic downturn of the 1980's and subsequent slump in oil prices, left states with huge foreign debts, and (due to failed investments) no way to pay them off. The impact of the downturn amongst Gelb's six developing states is considerable. 'In 1980-1982, commodity exports, in current dollars, shrank by 21.6 percent as imports rose by 22.3 percent, so that current account balances shifted to a deficit of \$19.6 billion by 1982'.⁷⁸ The legacy of the 'big spend' policies undertaken by Sub-Saharan regimes during the 1970's and early 1980's, was one of enormous debts that would stunt development for decades to come. Karl explains that:

'In 1999, the total Congolese debt was approximately \$5.4 billion, amounting to a huge total debt-to-GDP ratio of 245.3 percent, and much of this was based upon oil backed loans at high interest rates. Congo has been contracting such loans for about two decades, and these now account for around half of the country's total debt'.⁷⁹

Another major consequence of the 'big spend' strategy undertaken by developing oil producers, was that the overall economy was severely disrupted by such a

⁷⁶ Ibid, p72

⁷⁷ Karl, (2003), p35

⁷⁸ Elgar, Edward, 'The Curse of Natural Resources', (European Economic Review), 2001, 45, 827-838.

⁷⁹ Karl, (2003), p35

sudden injection of foreign currency. Countries such as Nigeria suffered from rapid inflation as more labour and resources were pulled into the booming oil sector; the result was that small scale manufacturers and agriculturalists were increasingly undermined. In Congo Brazzaville, the effect was no less damaging as other sectors of the economy, particularly forestry and agriculture, declined sharply throughout the boom years of high oil revenues. 'Many peasants left their farms for the promise of jobs in the city, while subsidies on imported food made it unprofitable to produce food for local markets'.⁸⁰ The appreciation of the currency (boosted by such large quantities of foreign revenue) made it harder for such sectors to sell their produce on the international market, and the loss of many workers to the cities and new oil based industrial centres, reduced levels of productivity.⁸¹ The boom effectively created all those symptoms associated with the 'Dutch disease'.

To summarize the pattern of allocation amongst Africa's oil producers during the previous oil boom, it was one in which funds were spent far too rapidly, in far too great a volume and with little prospect of long term success. Gelb explains that 'public expenditures, and in particular a vast expansion in the scope of public investments, constituted the main use of windfalls. Growth and modernization were the main goals of the expenditures'.⁸² In these goals, the producer states failed dismally, indeed the greatest consequence of their allocation mistakes was to saddle their countries with enormous debts, and to undermine and unsettle the existing economy by severely disrupting important tradable sectors such as agriculture. The policies undertaken by states in this boom period would help to stifle economic growth for decades to come.

In conclusion, states simply could not afford the spending programmes they undertook, a point which is reflected in the fact that they ran up such enormous debts. That the programmes were unsustainable is reflected in the fact that the majority were never completed after the fall in the price of oil; and finally, that the

⁸⁰ Clark, (1997), p74

⁸¹ Pinto, Brian, 'Nigeria During and After the Oil Boom: A policy Comparison with Indonesia', The World Economic Review, Vol 1, No. 3 (May, 1987) pp. 419-445.

⁸² Gelb (1988), p95

states themselves did not have the capacity to successfully undertake such projects, is reflected in the dismal record of mismanagement, corruption and logistical failures.

The outline of what should have been done with this revenue is now discussed.

How should states allocate their oil windfall?

For states to overcome the negative aspects associated with a resource boom, there are strong guidelines that are recommended. Richard Auty outlines two of the most important recommendations that states failed to undertake in the previous bonanza; he states firstly, that 'Oil exporters should have saved a far higher proportion of the windfall than they actually did' and secondly, 'spending levels should have been adjusted to sharp rises in oil income far more cautiously than they actually were'.⁸³

There is general consensus amongst the literature, that these recommendations are the foundation upon which a successful use of an oil windfall is based; for producer states to overcome the negative effects of a price bonanza, and increase their prospects of realizing long term economic growth, they must save a much greater proportion of their windfall, and any spending initiatives must be modest and introduced slowly. To be avoided at all costs are the huge spending programs which were the hallmark of the 1970's.⁸⁴

The reasons for saving a high proportion of the oil windfall, are twofold. First, by placing oil revenue in a special reserve, such wealth is effectively sterilized. That is,

⁸³ Auty and Mikesell, *Sustainable Development in Mineral Economies* (Clarendon Press, Oxford, 1998). P139.

⁸⁴ Auty, (1998)

Gelb, (1988)

Humphreys, Sachs and Stiglitz, *Escaping the Resource Curse*, (Columbia University Press, New York, 2007).

Karl, Terry Lynn, *The Paradox of Plenty: Oil Booms and Petro-States*, (University of California Press, London, 1997).

Okonjo-Iweala, Ngozi, *Nigeria's Economic Reforms: Progress and Challenges*, (Global Economy and Development Program, The Brookings Institute, March 2007)

Pinto, Brian, 'Nigeria During and After the Oil Boom: A policy Comparison with Indonesia', *The World Economic Review*, Vol 1, No. 3 (May, 1987) pp. 419-445.

it is prevented from disrupting the general economy, and instigating a reaction that is synonymous with the Dutch Disease. By sterilizing funds, a producer state can prevent real exchange appreciation, and unstable government expenditures. Such a use of funds effectively prevents enormous wealth falling directly into the hands of governments, and takes away the pressure and temptation to undertake enormous 'public projects'.⁸⁵

Secondly, by saving a higher proportion of oil revenue during a bonanza, states are able to considerably reduce the possibility that when the period of high prices ends, they will not be left with unfinished projects, large foreign debts and little or no reserves to help with the transition back to a period of considerably reduced oil prices. Auty explains that:

'The case of a 'Mineral Reserve Stabilization Fund' (MRSF) rests partly on the unpredictability of the revenue stream, over both the long run, and the short run, and partly the predictable inflationary effects of an overpaid absorption of the mineral rents. An MRSF can help to sterilize the revenue flows during boom periods, and also smooth the adjustment of public spending to the boom bust cycle'.⁸⁶

By saving a greater proportion of oil rents, the following important functions are undertaken.

- Foreign exchange expenditures are stabilized
- Real exchange rate appreciation or depreciation is prevented
- Government domestic expenditures are stabilized

By saving in the boom period, Africa's oil states avoid major disruption to the economy and secure for the future a steady income when the price of oil is reduced. Undertaking public projects should be kept within safe parameters, in which the state does not overextend itself financially, and invests in projects which have a significant promise of financial return; or in the case of social projects (such as improving education facilities or general infrastructure), can actually be

⁸⁵ Auty, (1998), p226

⁸⁶ Ibid, p227.

maintained into the future, rather than being dependent upon a period of inflated prices.

For the oil states of Sub-Saharan Africa, the last oil bonanza instigated a period of rapid spending, huge social and macro projects which would ultimately lead to long-term recession and economic stagnation. In the recent period of inflated oil prices, the regions oil states have had the opportunity to undertake a more responsible use of their oil revenue, based upon the premise of saving a greater proportion of their wealth, and avoiding major and rapid spending initiatives.

In the final part of this chapter, I identify those areas into which the increased oil revenue has been allocated, and consider the prospect that oil states have diverged from the actions of their predecessors, and made major strides towards achieving sustainable development.

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Part II: Empirical Results.

The aim of this final section of the chapter is to identify where Sub-Saharan oil states have allocated their increased wealth in the recent period of inflated oil prices. I hope to establish whether these countries are making the same mistakes as their predecessors, or whether they have undertaken the main recommendations in terms of resource allocation and investment, as outlined by the existing literature.

My findings are clear on several points; the first is that oil producers have saved the majority of their increased revenue, they have not undertaken large scale public projects (except in infrastructure), and overall they have reduced their external debt rather than increase it. In short, the oil states have vastly improved their prospects of long term development, and have on the large, avoided those disastrous patterns of allocation which so blighted their predecessors.

The structure of this final section is broken down into four sections. The first measures allocation of funds into the public sector; the second, measures the level of wealth that has been allocated into 'national savings' and 'paying off the external debt'; thirdly I test the validity of my main findings with control variables. I then draw conclusions out of my findings and compare patterns of allocation in the recent period 2002-2006, to the main conclusions drawn out from the 1970's. Finally, I assess the current pattern of allocation in light of what has been recommended by the existing literature, and outline why the prospect of sustained economic development has improved considerably.

Section I: The Public Sector

Using data taken from the World Bank World Development Indicators I have measured the amount of wealth (per year) allocated into each public sector between 2002-2006. Thus I have been able to calculate the amount of change (in the levels of government expenditure) between the years, 2002-2006, and to assess whether government spending has increased or decreased in the chosen sector, in the specified period. The range of the data encompasses all of Sub-Saharan Africa, and states are divided between oil producers and non-producers.

Figure 3 shows that Non-oil producers are allocating a greater amount of wealth into the public sectors in comparison to the regions main oil producers. In effect, the oil boom period has not corresponded into oil states allocating more money into the public sector; in fact their allocation of funds has been reduced. Whilst one would expect the increase in oil revenue to follow the same pattern of increased spending in the public sector, (like that of the 1970's), in fact oil states have reduced levels of spending in this area.

In terms of manufacturing, health, education and the military, the percentage of government allocation for oil producers has dropped a small amount, but remained largely consistent. Whilst in the 'service' and 'agricultural' sectors, there has been a more considerable drop in terms of central funding. Data is measured as a percentage of GNI.

Figure 3⁸⁷

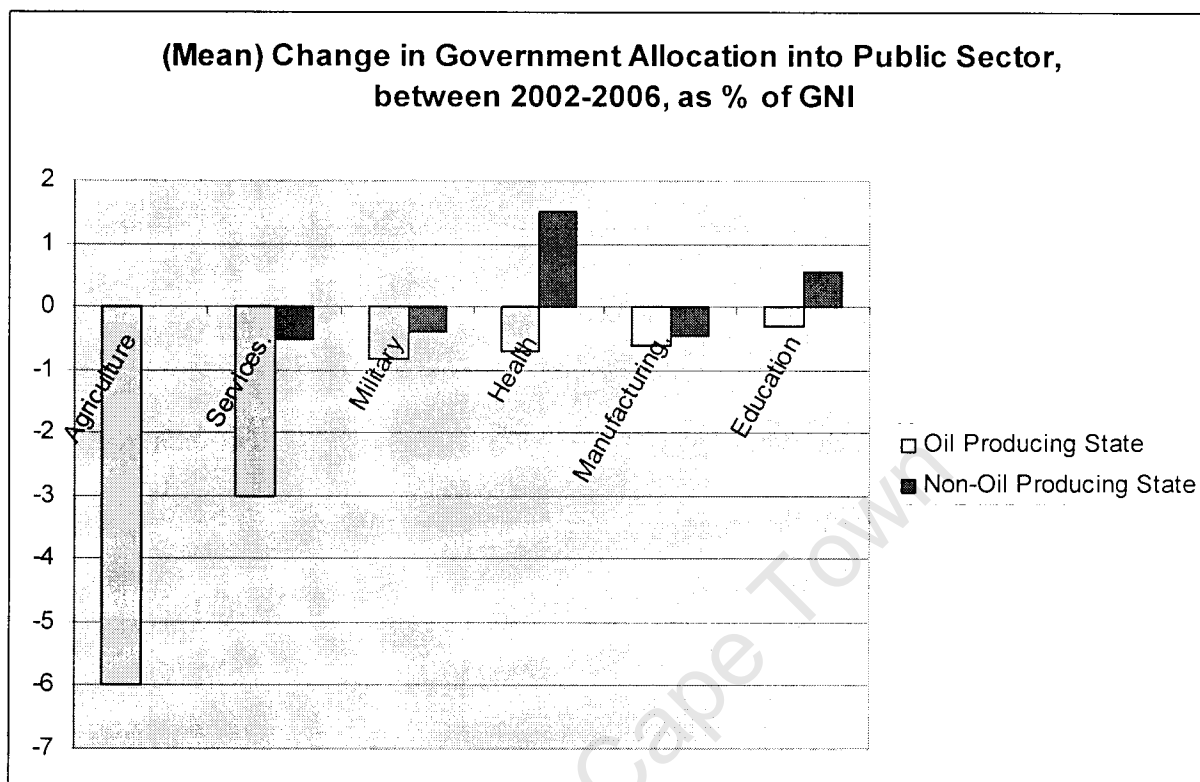


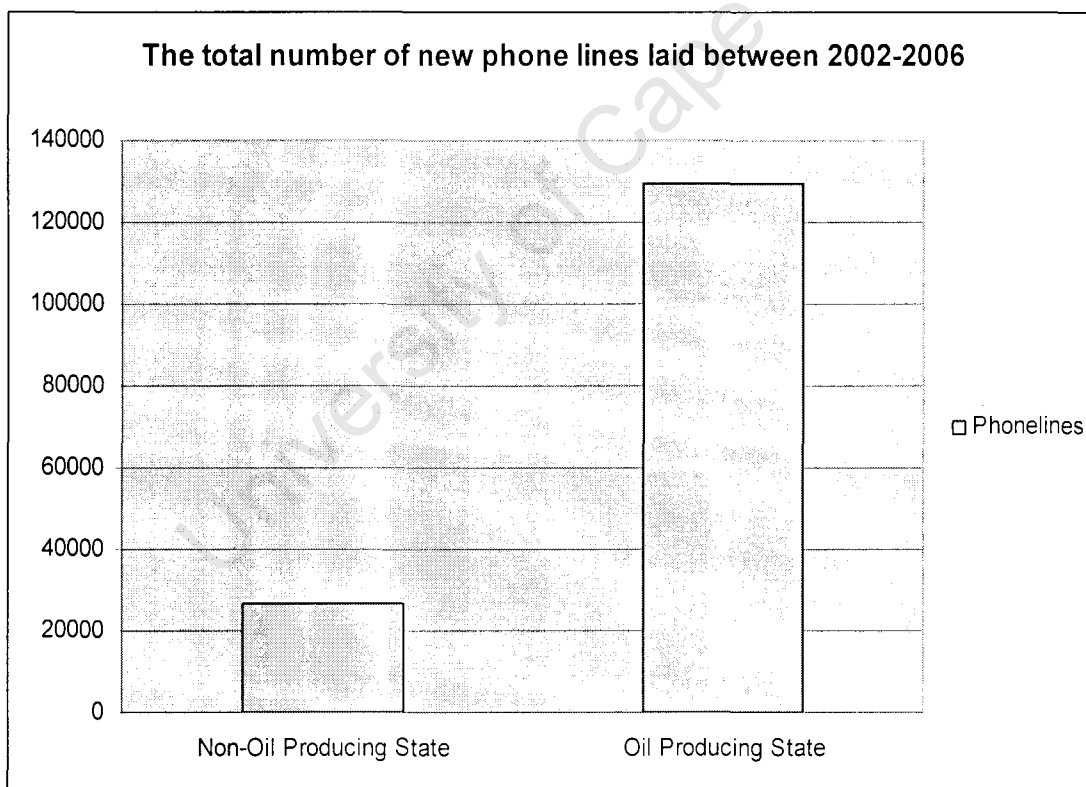
Table 1 Change in Public sector allocation. Measured as a % of GNI. (2002-2006)

		Agriculture,	Services	Military	Health	Manufacturing	Education
Oil Producing State	Mean	-6	-3	-0.8333	-0.7	-0.6	-0.3
	N	10	10	6	10	10	10
	Std. Deviation	6.716	7.288	0.40825	4.90011	2.011	0.48305
Non-Oil Producing State	Mean	0	-0.52	-0.4	1.5152	-0.46	0.5484
	N	26	25	20	33	24	31
	Std. Deviation	3.25	3.393	0.75394	5.82624	1.587	0.80989

⁸⁷ The change in 'central funding' is measured as a (mean) percentage of GNI between 2002-2006.

Figure 3.1, highlights the one sector in which oil producing states have clearly allocated a far greater amount of wealth compared to non-producers, that is in terms of infrastructure (as represented by the total amount of telephone lines laid between 2002-2006). Unfortunately, it is not possible to measure spending on 'infrastructure' as a % of GNI (and thus make it easier to compare to the rest of my data); nor is it possible to make a more accurate assessment on the amount of phone lines laid, (for example as a % of population), due to the fact that sufficient data does not exist. Thus the absolute figures which I have collected are a crude measure of how much government revenue has been allocated towards the important sector of infrastructure.

Figure 3.1⁸⁸



⁸⁸ My results are based upon the 'mean average' of the total number of phone lines laid between 2002-2006.

Table 1.1, Changes in the number of total phone lines laid between 2002-2006

		Total Phone lines
Non-Oil Producing State	Mean	26431.7333
	N	30
	Std. Deviation	76660.4763
Oil Producing State	Mean	129332.125
	N	8
	Std. Deviation	348853.842
Total	Mean	48094.9737
	N	38
	Std. Deviation	171574.248
	Median	8856.5

In summary, levels of public spending for oil producers have not increased over the oil boom period (2002-2006). Indeed with the exception of 'infrastructure', levels of government spending in the public sector have moderately declined over the period. The oil boom rather than initiating a period of rapid and increased spending in the public sector, (like that of the 1970's) has in fact resulted in a slight decline in spending amongst the group of oil producers.

Section II: 'National Savings' and 'External Debt'

Figure 3.2 shows the change in the amount of wealth that has been allocated to paying off the external debt. The range of the study, again, encompasses all of Sub-Saharan Africa and is broken down between oil and non-oil producers.

The figure shows that in terms of the amount of wealth being allocated into paying off the external debt, the group of oil states outperforms the group of non-producers. Oil states have reduced the amount of external debt by over 5.3 percent of GNI, in comparison to non-producers, who have reduced their external debt by just over 4.6 percent (GNI).

Figure 3.2

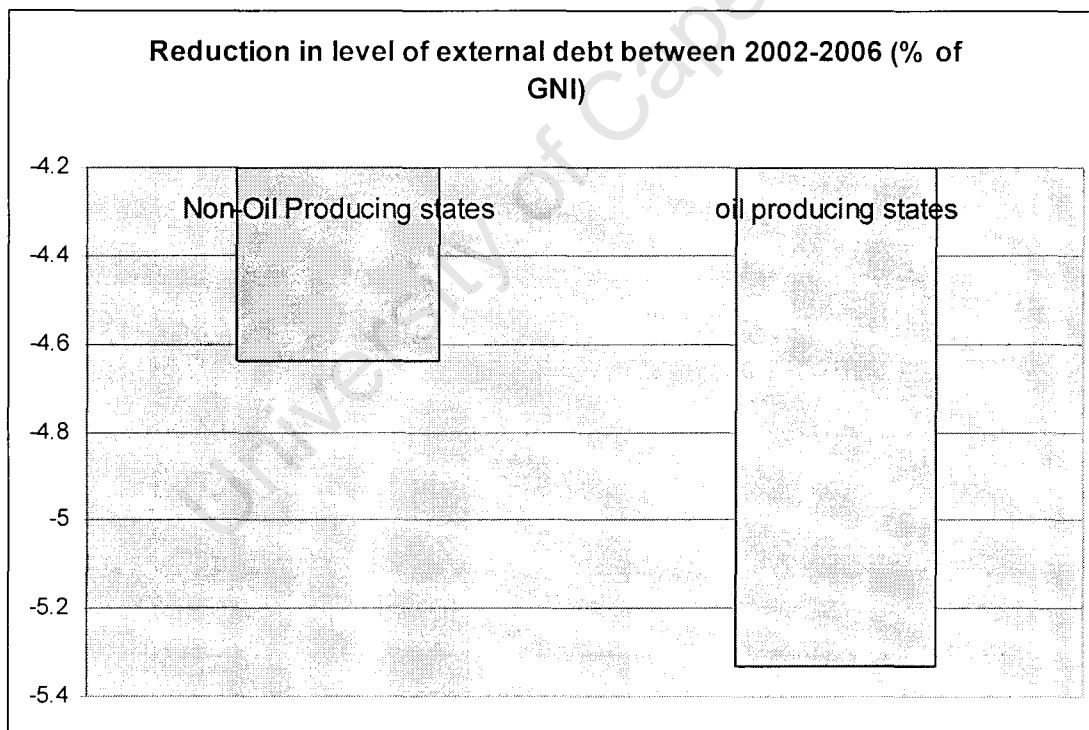


Figure 3.3 shows the change in the level of national savings between 2002-2006. The data is clear in making the point that the group of oil states are saving a much greater percentage of their revenue than non-producers. Put quite simply, in terms of increased savings, the oil states are outperforming the non-producers by an enormous margin. The data would indicate that the disparity between the two clearly highlights the point that a great deal of the increased revenue generated by

the oil boom, is being saved rather than directed into other sectors of the economy.

The data taken from the 21st century oil boom stands in complete contrast to the general pattern of spending during the 1970's and early 1980's. The broad conclusions to come out of that earlier era, was that states greatly increased spending in the public sector, there was no large measure of savings, and states quickly ran up enormous foreign debt. Quite clearly Africa's oil producers are wisely choosing to save a much greater percentage of their oil revenue, rather than undertaking ambitious public schemes of spending like their predecessors.

Table 1.2, summarises the data from tables three and four.

Figure 3.3

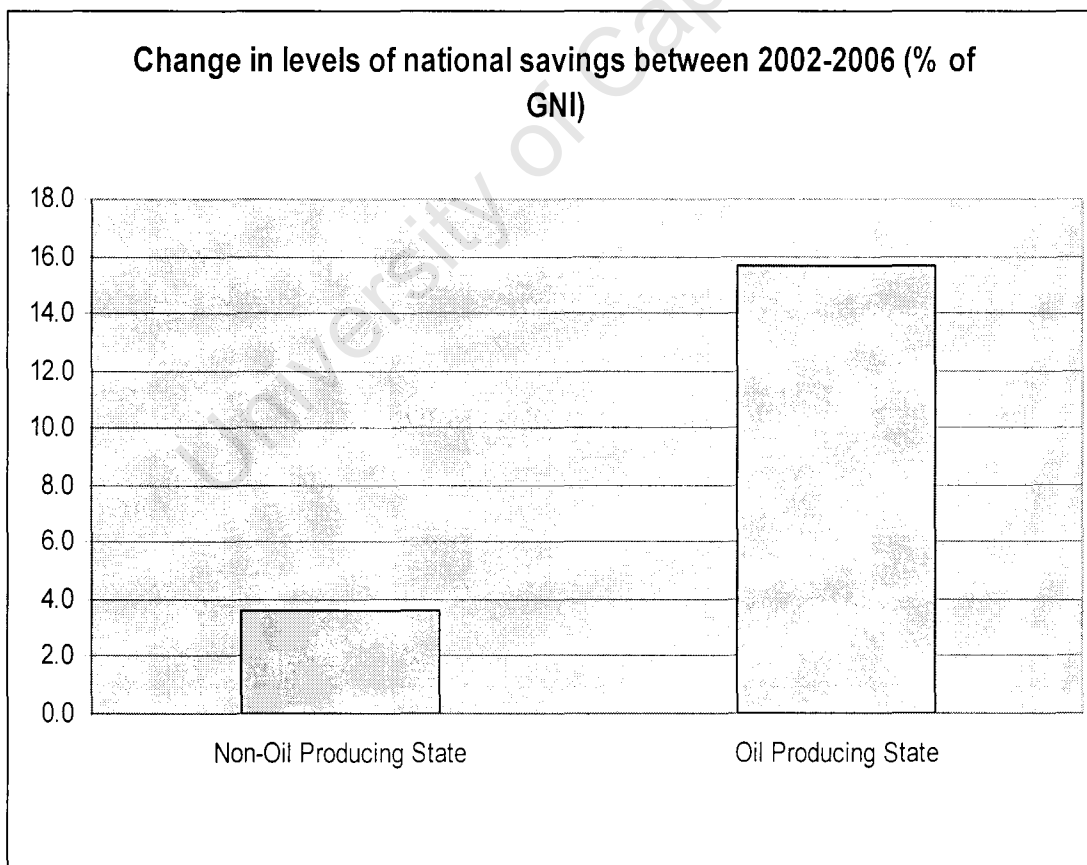


Table 1.2, Change in levels of External Debt and National Savings between 2002-2006 (Measured as a percent of GNI).

		Change in External Debt	Change in Savings
Oil Producing State	Mean	-5.33	15.7
	N	10	10
	Std. Deviation	2.730914	18.61332
Non-Oil Producing State	Mean	-4.64667	3.625
	N	30	24
	Std. Deviation	-3.831515	10.26523
Total	Mean	-4.8175	7.1765
	N	40	34
	Std. Deviation	3.567509	14.11097

Now that I have shown that oil producers are significantly different from non oil producers in terms of debt reduction and savings, I will now show that among the group of oil producers, the actual level of oil wealth is related to these variables.

Figures 3.2 and 3.3 highlight the strong link that exists between rising levels of oil wealth, in the period 2002-2006, and the reduction of external debt and increase in national savings. In effect, the increase in oil revenue has correlated into the positive fiscal changes experienced by oil producers. Thus I have shown that oil producers are not simply reflecting overall regional, or continental trends.

Table 1.3: Correlation between growing oil revenue and reduction in external debt

	Oil Wealth 0206 (Change between years)	Pearson Correlation	Oil 2002-2006	Wealth External Debt 2002-2006
		Sig. (2-tailed)	1	-.366
		N	10	.332
	ExternalDebt0206 (% of GNI) (Change between years)	Pearson Correlation	-.366	1
		Sig. (2-tailed)	.332	
		N	9	39

Table 1.4: Correlation between growing oil revenue and increased national savings.

	Oil Wealth 0206 (Change between years)	Pearson Correlation	Oil 2002-2006	Wealth Savings 2002-2006
		Sig. (2-tailed)	1	.313
		N	10	.378
	Savings0206 (% of GNI) Change between years	Pearson Correlation	.313	1
		Sig. (2-tailed)	.378	
		N	10	34

Summary

My empirical results have highlighted several important points. First, oil states have broken decisively with the policies undertaken by their predecessors during the 1970's and early 1980's. Second, they have improved their prospects of future development by saving a greater quantity of their wealth, reducing levels of debt and avoiding the temptation to undertake large spending programmes. Also, in the area of debt reduction and national savings, oil states are significantly different from the non-producers, a point which is further strengthened by the strong correlations that exist between rising levels of oil wealth and the reduction of debt and increase in savings.

In summary, the oil bonanza of the 21st century has meant that there exists a divergence between oil and non oil producers. Oil states have gained considerably from the oil boom and have increased the prospects of development, based upon a steady stream of income (from inflated national savings) and a considerable reduction in the level of debt.

In the next section, I assess the validity of these findings, and ask the question, might these changes simply be a function of other factors. Is it perhaps the case that these positive outcomes have been due to wider regional trends?

Section III: Validating my Findings with 'Control Variables'

The purpose of these control variables, is to test my main findings, which show that oil states as a group have made vast improvements in terms of how they allocate their oil wealth, and have thus improved their prospects of future development. To assess the validity of these findings is to make sure that they hold up once we consider other factors. Such factors may be that that the changes have come about in these countries due to wider regional trends. Such trends may be due to an increase of wealth across the region (as represented by growth in GDP), or that there has been an inflow of FDI, or that levels of trade have increased substantially (as represented by Total Exports).

Does the performance of the oil states between 2002-2006, still hold up when we account for 'control variables' such as GDP growth, FDI and Total Exports across the region?

Table 1.5 calculates the differences of means of oil producers and non-oil producers against my three control variables. The results clearly show that oil gives the oil producers a distinct advantage in overall growth, in attracting FDI and export revenue compared to the non-producers.

Table 1.5⁸⁹: Change in Levels of GDP, FDI and Total Exports between 2002-2006

Major Oil Producing African States / Non Producers		FDI	GDP	Total Exports
Oil Producing State	Mean	588.5000	1549.40	9745.0000
	N	10	10	10
	Std. Deviation	1568.74460	2835.314	14014.56389
Non-Oil Producing State	Mean	23.0303	364.53	2291.4074
	N	33	32	27
	Std. Deviation	191.26364	600.988	7505.48393
Total	Mean	154.5349	646.64	4305.8919
	N	43	42	37
	Std. Deviation	783.35656	1516.127	10052.25304

⁸⁹ Changes in FDI, GDP and Total Exports, are measured in millions (Current US\$) Taken from the World Bank, World Development Indicators.

Table 1.6 calculates correlations for increased oil revenue against each of the three control variables. The results show that clearly a link exists between the two.

Table 1.6: Correlations between change in oil revenue and control variables.

		FDI	GDP	Total Exports
Oil Wealth (2002-2006)	Pearson Correlation	.341	.312	.993
	Sig. (2-tailed)	.334	.379	.000
	N	10	10	10

Table 1.7 calculates correlations of the control variables (growth, FDI, trade) against the 'dependent variables' (savings and debt reduction). The results show that there exists no correlation between the two control variables and the dependent variables. Holding constant for such factors as GDP and FDI growth, as well total exports across the region, my main findings remain valid.

Table 1.7: Holding 'savings' and 'debt' constant against GDP, FDI and Total Exports

		GDP (2002-2006)	FDI (2002-2006)	Exports (2002-2006)
National Savings (2002-2006)	Pearson Correlation	.137	.045	.201
	Sig. (2-tailed)	.439	.804	.261
	N	34	33	33
External Debt (2002-2006)	Pearson Correlation	.212	-.117	.014
	Sig. (2-tailed)	.188	.473	.937
	N	40	40	36

Section IV: Summary of Findings

The Public Sector

In terms of the public sector, the levels of spending for oil producers have generally remained the same, or declined moderately, in comparison to non-producer states. The only sectors where there has been any significant divergence, is in agriculture, where there has been a noticeable decline in funding, and infrastructure, where there has been a sharp increase in allocation. The overall picture is one where oil states have actually decreased spending (apart from on infrastructure) in a period in which levels of oil revenue have been considerably increased.

In comparison to the conclusions taken from the period of inflated oil prices in the 1970's, there has been a strong break from the past. Africa's oil producers in the earlier period spent rapidly and funnelled vast sums of oil revenue into the public sectors. If one were to view patterns of allocation from this earlier period, the results would show great increases in the amount of funds allocated to such sectors as health, education and manufacturing.⁹⁰ In contrast, today's oil producers have been more frugal with their funds and there is no marked increase in terms of government spending in these areas (except infrastructure). The huge macro industrial projects, education and health schemes which were the hallmark of the 1970's period, and which caused such a burden upon the producer states, has simply not materialised in the 21st century period. The oil states, have it seems, avoided the temptation to 'spend quick and spend large'. There has been a considerable growth in the amount of money applied to building up infrastructure, (an agenda which was also followed by oil Africa's oil states in the 1970's) but this has not been accompanied with large scale spending in other areas.

In light of what is recommended by the existing literature, regarding the use of 'oil windfalls' by developing states, the patterns of allocation in the public sector are

⁹⁰ See section one of chapter six.

encouraging. The central recommendation, as advocated by analysts such as Gelb and Auty, is that states should not undertake large scale, rapid investment in the public sector. They emphasise the point that large spending initiatives based upon oil revenue are most likely to induce those negative forces associated with the resource curse.⁹¹ In the time of an oil boom, the temptation to spend is great, but the repercussions of doing so can be far reaching. My findings would indicate that oil producers have thus far been able to avoid this temptation.

The pattern of allocation, whilst not having an immediate impact (in terms of producing a more balanced economy), is though, a major improvement from the 1970's. Whilst the goal of attaining sustainable development based upon a diversified economy is still a long way off, by not overextending their capabilities, and not focusing upon a wider range of objectives, the chance of achieving long term results (which can be maintained long after the fall in oil prices) are made far more realistic. Thus the prospect that oil producers will undergo the same disastrous boom to bust cycle as their predecessors is made more remote.

National Savings and Paying Off the External Debt

My findings show that the majority of funds that were generated by the 21st century oil boom have been allocated into national savings, and to a lesser extent paying off external debt. The enormous divergence that exists between oil producers and non producers, in terms of the amounts of wealth that are being saved, highlights the sheer size of the windfall, and also highlights the area into which the great majority of oil related revenue is being channelled.

Comparing this pattern of allocation to that of the 1970's the complete contrast is clear. In the 1970's Sub-Saharan oil states undertook economic policies that were

⁹¹ Auty and Mikesell, *Sustainable Development in Mineral Economies* (Clarendon Press, Oxford, 1998).

Gelb, Alan H, *Oil Windfalls: Blessing or Curse?* A world Bank Research Publication (Oxford University Press, 1988).

based upon the maxim of spending as high a proportion of the 'windfall' as possible. Oil profits were funnelled into public projects as quickly as they were generated, and accompanying this extremely forward policy of 'spending big', states sought further funds from abroad and ran-up considerable debts. In complete contrast to this earlier period, current producers have chosen to save the majority of their funds, and rather than increasing their foreign debt, have considerably reduced this burden. The break from the past, in terms of how the oil windfall has been allocated, could not be more complete.

The oil states of Sub-Saharan Africa, are in effect undertaking the type of economic strategy that is recommended by resource-led development analysts. According to the literature, the central premise of any successful use of an oil windfall is based upon the central goal that the states save a substantial amount of that wealth, so that the money is in effect 'sterilized'. By saving a considerable degree of the funds, states are able to avoid the worst aspects of the resource curse, and establish stabilization funds designed specifically to deal with the volatile transition from inflated to normalized oil prices. Another important factor in determining whether the boom period is harmful or beneficial to the state, is whether that state undertakes large scale borrowing from foreign lenders. The contemporary oil states have thus far avoided this temptation; indeed they have actually lowered their level of indebtedness. Contemporary oil producers have in effect undertaken those recommendations which are essential, if the resource boom is not to become a destructive force in terms of long term development. In light of these changes, the future prospect of these countries attaining economic growth has vastly improved.

Conclusion

The data that I have analysed, and the main conclusions that I have identified, support my general hypothesis; that resource allocation amongst oil states has improved dramatically since the previous oil boom period. As such, the prospect that these countries will undertake long term growth initiatives, based upon a more responsible and sustainable use of natural resources, is greatly increased.

Chapter Seven:

The Case of Nigeria

My empirical findings show that African states, have to a certain extent, learnt from previous lessons, that oil wealth must be used more conservatively and with greater constraint. Indicative of this wider pattern is the case of Nigeria, which has in recent years undertaken many economic and political reforms, which have ensured that oil wealth is better used to stimulate development. Nigeria exemplifies, I believe, the wider trend of positive change that is occurring across the region in terms of how states are using their resource wealth, and thus I hope such a case study will compliment my empirical findings with a detailed case analysis.

The following chapter is broken down into two parts; the first focus's upon those factors which contributed to Nigeria's disastrous use of the increased oil revenue in the 1970's and early 1980's. Such factors include the authoritarian nature of the regime, misallocation of oil revenue and corruption. In effect I outline the Nigerian experience in this period, and identify those specific variables that ensured that the previous oil boom would lead to years of stunted development rather than positive growth. The second part of this chapter, examines the progress that Nigeria has made in terms of overcoming these barriers, and the types of economic and political reforms that have contributed to this positive change. Thus the central questions that I wish to tackle, are whether the government has undertaken a more responsible and realistic use of the increased oil revenue? Has the political environment improved? Or has the recent oil boom been marred by the same practices of corruption and mismanagement that was endemic to the Nigerian experience of the 1970's and early 1980's?

Part I: Nigeria's wasted Years

The increase in the price of petroleum, beginning in 1973, had an enormous impact upon Nigeria in terms of the money that was suddenly made available to the government. 'Adjusting for inflation, the value of Nigeria's exports more than tripled between 1972-1977, and rose another 50 percent by 1980'.⁹² The huge influx of petro-dollars meant the government's fiscal situation was entirely transformed. 'Petroleum taxes were about 8 percent of GDP in the 1971/72 fiscal year, rising to 9 percent in 1973/74, and 20 percent in 1974/75'. Such an increase in funds meant that the government was awash with money, but the consequences of this extra revenue were from beneficial to Nigerian development.

The increase in funds had two serious long term effects upon the Nigerian economy, the first of which was that important sectors, such as agriculture, began to contract as resources and manpower became focused solely upon the booming oil sector. Food production in Nigeria fell throughout the 1970's, and resulted in the country, that had been a net exporter of food, becoming a large net importer by the end of the decade. Brian Pinto explains that:

'In Nigeria, the oil boom led to a severe disruption of the agricultural economy and a large exodus of labour to the cities. Between 1970 and 1982, annual production of Nigeria's major cash crops, cocoa, rubber, cotton and groundnuts, fell by 43, 29, 65 and 64 percent respectively. The share of agricultural imports in total imports increased from about 3 percent in the late 1960's to about 7 percent in the early 1980's'.⁹³

In effect, Nigeria was severely affected by the worst aspects of the 'Dutch Disease' which was to cripple those sectors of the economy unrelated to oil, and especially undermine rural development.

⁹² Gavin, Michael, *Adjusting to a Terms of Trade Shock: Nigeria, 1972-88*, in Rudiger Dornbusch, (ed) *Policymaking in the Open Economy: Concepts and Case Studies in Economic Performance*, (published by the World Bank, 1993). p172

⁹³ Pinto, Brian, 'Nigeria During and After the Oil Boom: A policy Comparison with Indonesia', *The World Economic Review*, Vol 1, No. 3 (May, 1987) p433

The second major long term impact upon the Nigerian economy, was that the country became subsumed under enormous foreign debts, rapid inflation and a major budget deficit by the beginning of the 1980's.

'During 1981 the current account moved from the \$5 billion surplus recorded in 1980 to a deficit of \$6 billion. By 1987, Nigeria's international debt had risen to over \$9 billion. In 1987 individuals owed an average of about \$269 per person to foreign creditors. Inflation during the five years leading up to 1973 was just under 10 percent a year; during the five years leading up to 1988, inflation averaged almost twice that figure. And whereas the naira traded for \$1.52 in 1973, it was worth roughly 14 cents by mid 1989.'⁹⁴

The oil boom period, had in effect, all but destroyed Nigeria's non-oil related economy. The country was saddled with a crushing debt, and was set upon a course of negative development for years to come.

Nigerian politics, poor policy and corruption

To understand why the oil boom had such a destructive outcome upon Nigeria, it is necessary to identify those factors which were key to unleashing the negative forces associated with the resource curse. Thus I identify the type of political regime within Nigeria, the policies undertaken by the government at the time, and levels of corruption as central factors in determining the countries disastrous use of its oil revenue.

The military Regime

The increased oil funds of the 1970's and early 1980's, left the military dictatorship with important decisions to make. The most central of which, was whether it would be more beneficial to save a greater proportion of the increased funds and

⁹⁴ Gavin, Michael (1993), p209.

introduce them slowly into the economy, (thus undertaking a more conservative approach); or was it better to spend the money rapidly and look for quick results within the domestic economy? The military regime chose to undertake an enormous programme of spending, and the Nigerian economy was effectively tied to a boom to bust cycle. When oil revenue was high, government spending increased dramatically, whilst when the oil price was reduced, the state was left with crippling debts and incapable of further development. The reasons why the regime chose to undertake this failed economic policy are now discussed.

At the outbreak of the 1973 boom, Nigeria was under the authoritarian rule of General Gowon, who had seized control of the state in 1967; the General had a tentative grip on power, and saw the increased oil revenue as a tool by which he could further secure the position of his regime. The unpopularity of the regime, the clamour for a return to civilian rule, and the sudden rise in oil revenue placed considerable pressure upon the military government to justify its continued grip on power. The turbulent nature of Nigerian politics in this period is outlined by Charles Jarman:

*'By early 1975, there were signs of popular unrest across Nigeria. Student demonstrations, worker strikes and widespread dissatisfaction with the authoritarian government and poor standard of living, all were creating an unfavourable climate for Gowon's regime'*⁹⁵

Across all spectrums of society there was general discontent against the nature of authoritarian rule, and this discontent was coupled with growing demands that the regime undertake a large spending programme, to help spread the new found wealth amongst the general population.⁹⁶ For example, public employees (who were an important foundation of support upon which the government relied), increased their demands for higher wages in light of the growing oil prices. The Gowon regime quickly accepted these demands and the average pay for civil

⁹⁵ Jarman, Charles, *Nigeria: Reorganisation and Development since the mid-twentieth century*, (Published by E.J Brill, 1988) p61.

⁹⁶ Lawson, Kay, *'Nigeria's Future Constitution: Academic Hopes Vs Military Intentions'* (Journal of African Studies, 3/Spring 1976.

servants was doubled. This increase is thought to have increased the public sector wage bill by 50-60 percent.⁹⁷

In 1974, in an attempt to lessen popular feeling against the regime, the government set out its economic and social goals for the next decade, in what was known as the Adoji Accords.⁹⁸ The accords have been interpreted by commentators as an attempt by Gowon to justify his position in power, for as they were released the General also explained why he believed the country was not yet ready to be transferred back to civilian rule (which he had promised when he took power).⁹⁹ The feeling amongst the government was that it had to spend money quickly or face the possibility of major insurrection. Gelb, explains that:

'The government was in a hurry to spend its oil revenues. It wanted to avoid being accused of not spending when Nigeria was so poor. Increasing wages was one way to spend money rapidly. Investing heavily in education, transportation, and construction was another. Officials involved in formulating plans for the public sector have related how orders came down to multiply spending on education and transportation'.¹⁰⁰

The regime of General Gowon and the successive military regimes that followed him chose to ignore the conservative approach to spending and undertook a rapid programme of investment. These programs would become so far reaching, that the increased oil income alone would not suffice to pay for all the programmes undertaken. For example:

'Public capital spending accelerated from only 3.6 percent of non-mining GDP in 1970 to 29.5 percent by 1976. This acceleration was so strong that it alone absorbed more than the entire increase in oil income between 1970 and 1976. The excess, together with a considerable rise in current spending, resulted in a substantial deficit that was financed by drawing down reserves accumulated in 1973 and 1974 and by expanding the money supply'¹⁰¹

⁹⁷ Gavin Michael, (1993) p241

⁹⁸ The accords set down the governments' plans for major public spending in areas such as education, infrastructure and health.

⁹⁹ Gavin, (1993) p174

¹⁰⁰ Gelb (1988), p242

¹⁰¹ Ibid, p241.

To undertake such spending may have been excused, if it was based upon a source of revenue that was constant and unlikely to decline. To undertake a programme of spending based upon such a volatile commodity as oil, was an extremely dangerous strategy that would have enormous repercussions.

Though the large spending initiative on the surface appeared to be positive and directed at general development and reduction of poverty, in reality the state could not afford such a programme; it did not have the means to successfully implement such grand ideas, and undertook the initiative due to fears of social unrest and anger against the authoritarian regime.

In effect then, the decision to undertake a major programme of spending was based upon political necessity rather than sound rational economic sense. The nature of the regime ensured that there existed no economic institutions outside the control of the government that could formulate sensible economic policy, free from the pressures of political strife, and corruption. In effect there was no independent body, such as the ministry of finance, able to counter the military regime and its intent to undertake an entirely irrational use of the oil revenue.¹⁰² The intoxicating lure of the oil bonanza and volatile nature of the political environment, led in Michael Gavin's words to 'a time of lurid fiscal and monetary excess, carried out essentially with no regard for budgetary realities.'¹⁰³

Corruption and Misallocation

Coupled to the damaging effects of Nigeria's political environment and the knock on effect this had on the decision to undertake a major spending programme, there also existed rampant corruption and misallocation of funds, that helped to reinforce the subsequent economic downturn.

The extent of corruption in this period was truly staggering, for example during the Gowon regime, ten state governors were found guilty of corruption for using their

¹⁰² Gavin, (1998), p196

¹⁰³ Ibid, p198.

offices to enrich themselves with petroleum rents, and in 1979 an internal audit revealed that \$5 billion was 'missing' from the state oil company, Nigerian National Petroleum Corporation (NNPC)¹⁰⁴ Along side the outright corruption in this period, funds were misallocated due to incompetent planning and administration. The 'cement scandal' of 1975 best exemplifies this situation, when Nigeria ordered 16 million tons of cement, but lacking port space, left over 260 ships lying offshore laden with their cargo.¹⁰⁵ The government also undertook enormous industrial projects that had little hope of ever being completed and yet soaked up vast sums of money. The construction of a liquefied natural gas (LNG) facility at Bonny, stands out as just one of many such projects of the era. The cost of the 'LNG' project ran into billions of dollars and was eventually scrapped after the dramatic fall in oil prices in the early 1980's.¹⁰⁶ The enormous steel complex at Udoja stands out as another example of the 'big spend' policy that was based upon weak foundations. The complex was completed in the mid 1980's, but overrun its original cost forecast by up to fifty percent, and remains to this day heavily subsidized and a great burden upon the economy.¹⁰⁷ It was often the case that such wasteful projects were undertaken due to procurement bribes. Government officials would give the go ahead to major projects such as the Udoja steel complex, regardless of their practicality and cost, based upon the fact that they themselves would secure large capital incentives from competing contractors.¹⁰⁸

¹⁰⁴ Yates, Douglas, (1996), p232.

¹⁰⁵ Ibid, p232.

¹⁰⁶ Ibid, p232.

¹⁰⁷ Gavin, (1993) p205

¹⁰⁸ Ibid, p205

Conclusion

The weak, dictatorial nature of the Nigerian government resulted in the vast riches of the oil boom being squandered away on rapid investment programmes that were based upon political necessity, rather than sound economic rationale. The viability of these projects was further undermined by corruption and misallocation. The Nigerian state overreached itself, and when the cost of petroleum dramatically declined in the early 1980's, the years of rapid spending, waste and corruption were to condemn the country to decades of underdevelopment. The type of regime that was in place, and the whole Nigerian experience in this early period, was indicative of the wider region in general, and especially amongst the group of oil producing states. The question that must be tackled now, is whether those same factors which helped to ensure Nigeria's misuse of its oil revenue in the 1970's and early 1980's, are still as prevalent in the current era? Has Nigeria been able to improve its political environment, allocate its resource wealth more responsibly and tackle corruption?

Part II: Nigeria's Reform Programme

In this section of the chapter I assess the progress that has been made in Nigeria, in terms of how that state has overcome those factors that severely undermined resource led development in the 1970's and early 1980's.

Real change came to Nigeria after the election of President Olusegun Obasanjo in 1999. The new president was brought to power on a wave of democracy that was sweeping the continent in the 1990's. The new democratically elected president immediately embarked upon a comprehensive reform programme, based upon the need to radically alter the economic and political foundations upon which the state rested. Upon taking power Obasanjo outlined his main objectives in 'The National Economic Empowerment and Development Strategy', (NEEDS). The programme was focused upon four main areas; macroeconomic reform, structural reform, public sector reform, and institutional and governance reform.¹⁰⁹ By assessing how effective these new reforms have been, I hope to make clear the point that Nigeria has made positive progress in terms of overcoming those factors that in the past had such a negative impact upon resource led development. In effect the democratic movement and the subsequent reforms, has changed the political environment to one that is poised to utilise its oil wealth and overcome the resource curse.

Changing the Political Environment

The degree to which Nigeria has successfully made the transition towards democracy is a contentious issue. The election of President Obasanjo marked the end of the military dictators, but the subsequent elections have been marred by irregularities, accusations of intimidation and vote rigging. Indeed the election process in 2007 led one political commentator to state that 'ballot stuffing was widespread, millions of voters were unable to vote due to a shortage of ballot

¹⁰⁹ Okonjo-Iweala, Ngozi, *Nigeria's Economic Reforms: Progress and Challenge*, (Global Economy and Development Program, The Brooking Institute, March 2007) p7

papers, and on the eve of the vote, an army truck was stopped and found to be carrying thousands of ballot papers completed even before the polls had opened'.¹¹⁰

Such incidents undermine the credibility of democracy in Nigeria, but there can be little doubt that whilst the process of democratization is by no means complete, there has been significant progress. For example the International Institute for Democracy and Electoral Assistance (International IDEA) undertook a study to measure the progress that Nigeria has made in terms of democracy and freedom since 1999. The main findings of the study revealed that:

'Since the transition significant progress has been made in the area of personal freedoms and liberties. The transition has made possible a new, more open society in which people no longer live in fear of the military. Thus despite the challenges, Nigerians remain optimistic about the future of democracy in their country'.¹¹¹

The fact that Nigeria has now experienced over ten years of democratic rule, and in that time experienced its first ever democratic and voluntary transfer of power, is the greatest indication that there has been positive change to the political environment. The military regimes of the past had little continuity, were extremely volatile in nature and provided little stability in terms of maintaining long term economic policy. Indeed between 1966 and 1999 there were no less than 6 military coups in Nigeria and two political assassinations of incumbent military leaders.¹¹² Though the transition to democracy has by no means been accomplished, the process has certainly had the benefit of giving Nigeria a much more settled political environment in which the task of major reform can be undertaken. Thus the democracy movement in Nigeria has had a twofold effect; first it brought about a major programme of reform, and secondly it gave a much

¹¹⁰ Perry, Alex, *A failure of Democracy in Nigeria*, (Reuters News Agency April 21, 2007)

¹¹¹ International Institute for Democracy and Electoral Assistance, *Positive progression in Nigeria's new Democracy*, (International IDEA) October 25th 2006
http://www.idea.int/publications/democracy_in_nigeria/index.cfm

¹¹² BBC News, *'Nigeria a History of Coups'*, February 15, 1999,
<http://news.bbc.co.uk/1/hi/world/africa/83449.stm>

more stable foundation to the political environment. The effectiveness of some of those reforms in tackling corruption and misallocation are now assessed.

Taking on Corruption

Perhaps the greatest effect of the democracy movement in Nigeria, was that with a new democratic outlook and a new type of regime, came a great wave of reforms that were focused upon tackling those issues that were so damaging to Nigerian development in the past.

When the Obasanjo led government came to power in 1999, the central policy upon which they based their election campaign was to tackle the scourge of corruption across Nigeria. This focus led to the 'Corrupt Practices and other related Offences Act'. Sequel to this, 'the Independent Corrupt Practices Commission' (ICPC) was established. These efforts have led to an increasing sense that Nigeria is beginning to turn the corner on corruption. According to transparency international's 'Global Corruption Barometer, 2007, 62% of households believed that corruption would decrease within three years, and 64% believed that the government's efforts to fight corruption were effective'.¹¹³ In real terms, the progress that has been made by Nigeria in this area is reflected in the World Bank, World Wide Governance Indicators, which show that Nigeria in 2002, was ranked as the second most corrupt country in the world; in 2008 the country has moved up sixteen places, to eighteenth position.¹¹⁴ A remarkable change, achieved in just over five years. That Nigeria has experienced a positive change in terms of tackling corruption is clear to see; I now assess the practical impact that the positive reform initiative has had, on overcoming those barriers to sustainable resource led development.

¹¹³ Taken from the Business anti-corruption portal.
<http://www.business-anti-corruption.com/en/country-profiles/sub-saharan-africa/nigeria/background-information/>

¹¹⁴ The Worldwide Governance Indicators (WGI) project
<http://info.worldbank.org/governance/wgi/index.asp>

As outlined in section one of this chapter, one of the most damaging aspects of government policy during the 1970's, was that the government undertook construction and large spending programmes that were entirely unjustified in terms of economic value. One of the reasons for this predicament was that government officials were happy to give the go ahead to projects on the assurance that they would be well rewarded by contractors. To curb this unnecessary waste of funds and prevent corruption, the Obasanjo regime introduced in 2001, 'The Due Process Mechanism' which promoted an open tenders process with competitive approval. In effect competing contractors had to make bids that were open to public scrutiny and based upon a realistic price. With the introduction of the 'Due Process Mechanism', there has been a notable improvement in the efficiency of capital spending. The positive impact of this reform measure is reflected in the fact that the federal government, between 2001-2006, has saved over \$1.5 billion in the form of reductions from inflated contract prices.¹¹⁵ The government in effect has taken strong measures to tackle one of the most damaging factors that helped ensure such enormous waste in the 1970's and early 1980's.

There have also been considerable improvements in levels of fiscal transparency within the government, due to the monthly publication of all federal, state and local government shares of revenue. Also, within the oil and gas sector itself, the veil of secrecy in terms of how, where and in what amounts money is being allocated has been lifted. In 2003, Nigeria with considerable support and encouragement from such organisations as BP and the World Bank, signed up to the 'Extractive Industries Transparency Initiative' (EITI), which opened to all observers the amount of wealth being generated, and allowed for the commission of an independent audit into the oil and gas sector.¹¹⁶ The Nigerian government has clearly begun the process of cleaning up the industry and tackling some of the corrupt practices associated with resource allocation.

¹¹⁵ Okonjo-Iweala, (2007) p18

¹¹⁶ Ibid, p18

The end of the military dictators and the reform programmes undertaken by the government, have also had the effect of stimulating civil society groups into action. The best example of this is the 'Zero Corruption Coalition' (ZCC), which is an association of civil society organisations engaged in the campaign against corruption. 'The coalition was formed in 2001 with a mission to stimulate the active involvement of the populace in the fight against corruption. The ZCC currently has a membership of over a hundred civil organisations spread across Nigeria'.¹¹⁷ The organisation has been an important component in the fight against corruption, it has been actively encouraged by the government and marks a new dimension in relations between the public and private sphere. Such initiatives would have been unheard of during the military era of political domination.

Though these efforts have made a substantial impact, the process of greater democratization, better governance and economic reform has been a slow and painful process since the elections of 1999. That Nigeria still experiences corruption on an enormous scale cannot be denied. The Niger Delta for example remains unsettled and rife with theft and corruption. In 2005, Nigeria's new anti-graft watchdog, 'The Economic and Financial Crimes Commission', estimated that 45 percent of the nation's oil revenues was stolen, wasted or siphoned away in the marshes of the Delta. In the same year two Nigerian navy admirals were convicted of facilitating the theft of an oil tanker, and the former police inspector general, Tafa Balogun, was accused of stealing \$98 million, most of which related to oil profiteering'.¹¹⁸

There clearly remains a great deal of challenges to overcome in Nigeria, but in light of the experiences of the country in the 1970's, Nigeria has undoubtedly taken great steps forward in terms of improving the political environment, and tackling corruption. The prospects of future development based upon resource extraction are, due to these improvements, greatly improved in the 21st Century. The reform

¹¹⁷ Taken from the Business anti-corruption portal.
<http://www.business-anti-corruption.com/en/country-profiles/sub-saharan-africa/nigeria/background-information/>

¹¹⁸ Donnelly, John, *Burdens of Oil weigh on Nigerians*, *Boston Globe*, October 3rd, 2005.
<http://www.globalpolicy.org/component/content/article/198-natural-resources/40247.html>

programme has made significant inroads into tackling corruption and there has been a groundswell of civil society action in support of the government's initiative.

Resource Allocation

Alongside improvements in the political environment and the strong stand against corruption, there has also been great progress in terms of how Nigeria actually uses its oil revenue.

As outlined in the first part of this chapter, one of the most negative effects of the previous oil boom had been that it closely tied the Nigerian economy to the volatile oil markets. In effect the ups and downs of the price of oil had a direct impact upon government expenditure in the domestic economy. The close connection between the price of oil and the Nigerian economy, also meant that the worst effects of the Dutch disease could take hold; (this essentially meant that exchange rates were extreme as was currency appreciation and a decline in non-oil related sectors). For these reasons the Nigerian economy ranked for many years as one of the most volatile in the world.¹¹⁹

To counter these damaging effects, the Obasanjo regime undertook measures that would essentially de-couple the economy from oil revenue earnings. Central to this plan was the intent to save a much higher proportion of oil revenue, and stabilize oil based government income to a set limit. The essential purpose of this task was so that if the price of oil sharply rose or declined, the amount of funds made available to the state would remain the same. Okonjo-Iweala explains that:

'In the case of Nigeria, an oil price based fiscal rule was introduced in which government expenditure was based on a prudent oil price benchmark. Any revenues that accumulated above the reference prices were saved in a special crude account. In recent years, government budgeting has been based on conservative oil prices of \$32 per barrel in 2004, \$30 dollars per barrel in 2005, and \$35 dollars in 2006, despite higher realized prices, which is emphasized by the fact that in 2006, it was \$68 dollars per barrel'.¹²⁰

¹¹⁹ World Bank Publication, (2003), *Nigerian Policy Options for Growth and Stability*, Report No. 26215-NGA, Washington DC: The World Bank

¹²⁰ Okonjo-Iweala (2007), p10.

Adoption of this rule ensured that the type of external shocks which played such an important role in bringing down the Nigerian economy in the 1980's, was enormously decreased. These measures also ensured that the level of national savings within the country soared to new levels in the wake of the, 2002-2008, increase in oil prices.¹²¹ By saving a greater proportion of oil revenue, Nigeria is effectively ensuring a steady stream of income even when the price of oil becomes reduced. Such a measure certainly gives a great degree of fiscal stability to long term development goals.¹²²

Another area in which important reforms have been undertaken is in debt management. As part of a wider plan to give greater macroeconomic stability to the country, there has in recent years, been an increased focus upon drastically reducing the level of international debt. The Nigerian government has made this a central policy goal, and has achieved substantial results. For example, 'public debt declined from 74.8 percent of GDP in 2003, to about 14.2 percent in 2006'.¹²³

The effectiveness of these fiscal reforms is perhaps best measured by assessing the impact of the recent fall in oil prices upon the Nigerian economy in 2009. Statistics make clear that whilst the economy has slowed due to the world economic downturn, there has not been a collapse in the value of the Naira (Nigerian currency), the state has not had to seek financial assistance from abroad, and limited spending programmes based upon improving the country's infrastructure have not been reduced.¹²⁴ The continued stability of the economy has been based upon the policy of prudence during the boom years, which allowed for considerable reserves to be built up (to deal with just such a downturn in prices), and the fact that the national debt has been considerably reduced. The picture in the post boom era of 2009 is in stark contrast to the drastic fall in oil

¹²¹ Ibid, p10

¹²² Gelb Alan, *Oil Windfalls: Blessing or Curse?* A world Bank Research Publication (Oxford University Press, 1988).

¹²³ Okonjo-Iweala (2007), p10.

¹²⁴ EDC Economics: Nigeria Country Overview, 2009.

http://74.125.47.132/search?q=cache:sSUVo0dGR3IJ:www.edc.ca/english/docs/gnigeria_e.pdf+EDC+economy+country+nigeria&cd=1&hl=en&ct=clnk

prices in the early 1980's, which saw a collapse of the currency, increased borrowing from abroad and the end of the majority of public spending programmes.

Nigeria's economic reform programme has changed dramatically the way in which oil revenue is used. Gone are the days when the state would spend the increased wealth as quickly as it was generated, and gone are the huge macro projects and social programs that were the hallmark of the 1970's. In place of these radical spending programmes, there is now an emphasis upon responsible use of oil revenue, which fits into a wider conservative approach to government policy. Key to this new policy is that states save a much higher proportion of their wealth, a point that corresponds directly to my own empirical findings that show a marked increase in savings, not just within Nigeria, but amongst the wider group of contemporary oil producers.

Conclusion

The change in the political environment and the subsequent reform programmes that were born out of this period of transformation, have resulted in a positive change to the way that oil wealth is allocated within Nigeria. The more conservative approach to spending, which is the result of these progressions, holds out a greater prospect that sustainable development can be attained, and that the boom to bust cycle has been considerably reduced.

Nigeria still has many barriers to overcome, but great inroads have been made upon tackling corruption and waste, as well as establishing a more stable political environment based upon democracy. These progressions are indicative of the wider region and support my empirical findings that show positive change, both in terms of the way that states allocate their resource wealth, and the type of political environment that now exists.

Chapter 8:

Conclusions

The modern history of Sub-Saharan Africa has been one of underdevelopment, missed opportunities and an inability to break free from the cycle of poverty. This situation has come about despite the fact that the region is one of the richest in the world in terms of natural resources. The inability of African states to utilise this enormous potential has been a central factor in determining the regions stunted development, and poor record of growth. Focusing upon the single commodity of oil, I have highlighted in this study the type of waste and poor decision making that ensured this potential source of prosperity was squandered away. But I have also shown in this study that this pattern of waste does not have to be inevitable. Indeed, I have found promising evidence that African states are undertaking a more responsible and far sighted approach to how they use their natural resources. Thus the prospect of Sub-Saharan Africa undertaking a positive step towards greater development is one step closer to becoming reality.

In this study I attempted to understand whether contemporary oil producers were undertaking the same mistakes (in terms of wasting their valuable resource) as their predecessors. I hoped to discover how states were allocating their wealth in the recent period of inflated oil prices, and compare these findings to the broad conclusions taken from the 1970's and early 1980's; I also hoped to discover whether the changing political climate had any effect on how resource wealth was used. The resulting empirical evidence which I gathered, offers a refreshing glance into the progress that has been made in this particular area, and also in the wider political domain. Such discoveries as I have made, will I hope, revise the current literature that focus's upon the inevitable downturns associated with increased oil wealth in developing countries.

Findings

In regards to the political environment, I hypothesized that there would be general improvements across the region due to greater stability, democracy and personal freedom; and that these positive changes would in turn have a positive impact upon how resource wealth was allocated. Using data taken from Freedom House I found that indeed there has been significant political and social progress, but not a total break from the past. Africa's oil states still remain only 'partly free' and they are a long way from attaining the 'full freedom' associated with an entirely democratic system. This should not detract though from the fact that greater democracy and personal freedom has taken root, not just amongst these oil states but across the region in general. My findings are further supported by a wealth of literature which highlights the positive transitions that have been made in terms of this political development.

In regards to resource allocation, I hypothesized that that due to improvements in the political environment, resource wealth would now be used to improve rather than hinder the prospects of future development. My data shows two significant points that help support this hypothesis; the first is that states have not undertaken large spending programmes within the public sector. Though such a spending programme would on the surface appear to be beneficial, in fact it is the case that amongst developing states such initiatives do more harm than good. As was shown by the disastrous experiences of the 1970's, and in light of what is recommended by economic analysts, it is much better to avoid such an undertaking, and to save as great a percentage of the excess revenue as possible during a boom period. My findings are clear upon the point that across the wider public sector, the oil boom has not correlated into a significant rise in spending. The second point highlighted by my data analysis, is that a significant proportion of resource wealth has been used to service the foreign debt, and to a much greater extent, the majority of funds have been saved. I also found that in regards to levels of savings and debt reduction petro-states diverge significantly from other states in the region. To further emphasise this point I have displayed strong correlations that exist between the rising level of oil wealth, the reduction in the level of debt

and the increase in national savings. The identification of where the majority of resource wealth has been allocated is further supported by my control variables, which held constant for such factors as general growth (GDP), foreign investments (FDI) and levels of trade (total exports) across the region.

Thus my empirical research has brought to light two important facts that are central to my overall argument. That is that the political environment has indeed improved since the earlier period of inflated oil prices; and secondly, there has been a significant break from the past, in terms of how oil states allocate their resource wealth.

Implications

The implications of these findings, would suggest that resource led development in the region is now a more realistic prospect. The improved political environment has ensured that states are not repeating the same economic blunders as their predecessors, and from a platform of much greater stability the responsible use of oil wealth has been made possible.

That current oil producers are undertaking a more cautious use of their resource revenue, implies that a significant corner has been turned in overcoming the disastrous legacy of the previous oil bonanza. It would not be wrong to think of these states in the past as irresponsible and naïve in terms of how they spent their wealth. In comparison, contemporary oil producers now appear more streetwise and realistic in their approach to resource allocation. The long term implications of this situation are twofold, first, it drastically reduces the possibility that states will follow the same boom to bust cycle as their predecessors, and secondly, the prospect of greater economic growth and development based upon resource revenue, is greatly increased. In light of these discoveries, it is important that we reassess the effect that a resource boom has on a developing state. The boom to bust cycle does not have to be inevitable, and the possibility of attaining resource led growth is now far more realistic than was the case thirty years ago.

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