Let us speak Dutch Disease

The abundance of natural resources should theoretically be a blessing for a state to develop its economy. The OPEC countries which, since 1973, have raked in 25,000 billion dollars, should undoubtedly be the richest countries in the world. However, so far this windfall has not allowed producing countries to triumphantly climb the ladder to development.

Observed in the Netherlands[1] in the 1970s when the giant Groningen gas field was put on stream, this paradox is not specific to the 20th century or the market economy. In the 16th century, Spain though flooded by gold from America, lost its competitiveness and its predominant place in Europe, a phenomenon explained by the negative effects of "*cash economies*" and the nature of the socio-political structures they promote[2].

The source of the cash (i.e. oil & gas reserves) being limited in time and non-renewable, the main challenge of a "*rentier state*" lies in its ability to transform financial income in productive assets quickly enough. In many cases, the amount of time required to design, plan, implement and carry such projects through to maturity is greater than the expected longevity of the natural resources. In other words, no money supply, however great, can transform in a "timeless" development process.

The accumulation of "unprocessed" money reinforces inflation, encourages significant distortions in the salary scale and increases the economic and social disparities. Inflation and artificial overvaluation of the local currency reduces the competitiveness of the manufacturing and agricultural industries in favor of the service sector.

In addition, the capital-intensive nature of the oil & gas industry mobilizes most of the investment at the expense of the other sectors which employ large workforces at a relatively low wage. The result is an **unproductive** and **singletrack** economy.

As in most producing countries, the subsurface belongs to the State, the rent strengthens its power. The State unilaterally decides on the allocation of funds and therefore the potential substitution strategy. More precisely, in most producing countries, the takeover of the oil and gas resources by the State testifies to what was perceived as a despised colonial heritage. But, where cash economies supplant a real entrepreneurial class, an "oil bourgeoisie"[3] with no real politic, economic or technical experience emerges, and indirectly seizes a share of the windfall. The rentier state upholds excessive oversized bureaucracy and itself practices an opaque policy of favoritism, often coupled with a high degree of corruption (**Figure 1**). The resulting "impoverished growth" is associated with an explosion of inequality[4].

Finally, cash economies are primarily consumer economies, in which a sophisticated demand appears in stark contrast to rudimentary productive activities thereby developing a distorted vision of modernity. Rentier states will always down cry productive activities in favor of quick, speculative profits. If the upswing gives rentier states the illusion of a very high flexibility, they become extremely vulnerable when the rent decreases.

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[1] For this reason, the phenomenon is called "Dutch Disease".
[2] Abdelkader Sid Ahmed (1987) « *Rente pétrolière : quelques problèmes théoriques* » Colloque ORSTOM, Paris.
[3] "Unfortunately the leaders issued from the colonial revolution were neither trained politicians nor economic experts. Most of us could neither read nor write. We were simple officers illiterate" Speech of M. Gaddafi in January 2000
[4] L. Martinez "*Violence de la rente pétrolière. Algérie, Irak, Lybie*" Nouveaux Débats. Sciences Po Les presses.

The political regimes prevailing in rentier states are almost always removed from their population insofar as they do not need democratic legitimacy (**Figure 1**) to stay in power and keep control of the resource. In addition, the risk of civil or regional war is estimated to be 20 times higher in countries where raw material exports represent more than one third of GDP[5].

Country	Democraty index	Corruption index
Saoudi Arabia	1,84	4,4
Iran	1,94	2,3
UAE	2,52	6,8
Kuwait	3,88	4,6
Irak	4	1,8
Venezuela	5,18	1,9
Nigeria	3,47	2,4
Kazakhstan	3,3	2,2

Figure 1 – Democracy and corruption of major oil & gas countries[6]

Sub-Saharan Africa is a typical case study of the Dutch Disease[7] insofar as the oil rent has been a medium-term source of recession in producing countries, whereas non-oil countries performed better, with a slight but positive growth (**Figure 2**). The same rules applied to North Africa and the Middle East. Between 1974 and 2004, the average growth of non-producing countries such as Morocco, Tunisia and Syria were larger than those of Algeria, Iraq and Libya. All the OPEC countries, without exception, experienced a lower growth than the world average between 1970 and 2000, confirming the weakness of cash economies.

Illusory revenge against the humiliating neocolonialism of developed countries and their IOC, an unlikely key to modernity and an ineffective weapon against underdevelopment, the oil nationalism of the 1970s was not materialized by increased wellbeing for the people. The sudden cash abundance in countries with poorly consolidated political institutions nullified the responsiveness of political leaders to the expectations of their peoples and drove most of the producing countries to an economic and social standstill.

Producing countries			Non producing countries		
GDP/inh (US$)		Average growth	GDP/inh (US$)		Average growth
1975	2003		1975	2003	
2 807	2 432	-0,5%	1 685	1 827	0,3%

Figure 2 – Comparison of economic growth between producing and non-producing oil & gas countries in Sub-Saharan Africa[8]

There are two basic ways to reduce the threat of Dutch disease: by slowing the appreciation of the real exchange rate and by boosting the competitiveness of the manufacturing sector, in particular the small and medium enterprises.

[5] Martinez L. (2010) "*Violence de la rente pétrolière*" Sciences Po Les Presses
[6] Indexes range from 1(low) to 10 (high - Source: www.statistiques-mondiales.com
[7] Gary I., TL Karl (2003) "*Bottom of the Barrel: oil boom and Poverty in Africa*", Catholic Relief Services
[8] Source: www.statistiques-mondiales.com

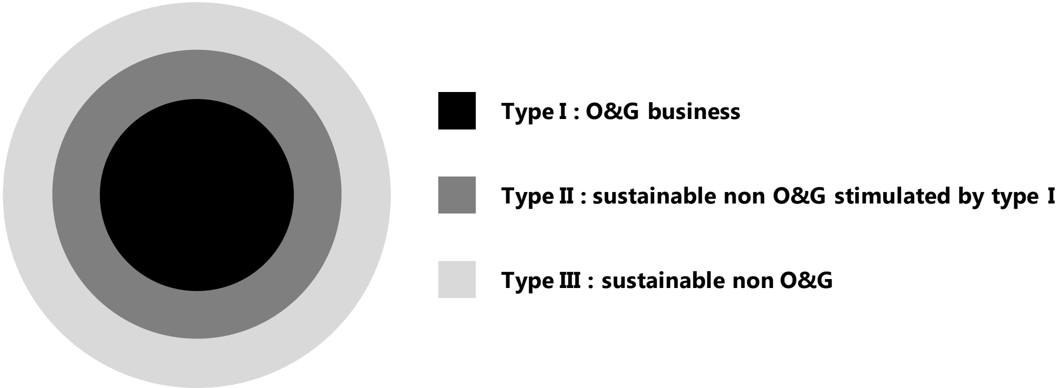

Figure 3 – The "*ring fence*" development concept

The goal consists in promoting the development of small and medium enterprises first of all in the Oil & Gas business itself (core) then progressively outside Oil & Gas business. While the second circle remains stimulated by Type I activities (for instance development of activities around sulfur transformation such as fertilizers or the chemical industry) Type III activities are supposed to be fully sustainable independent of Oil & Gas activities. Such a model uses the opportunity of all that is brought by the O&G project (facilities, roads, power, and water) to build a real industrial network. Type II and then Type III will progressively replace declining Oil & Gas activities to keep local and regional employment at a satisfactory level.