

Shifting Patterns of Demand and Supply

Oil, gas, and mineral resource wealth is widespread in developing states where it frequently accounts for a very high share of gross domestic product (GDP), export earnings, government revenues and jobs.¹ Its economic and social transformative potential for any country capable of producing it has long been evident². In a single generation, the conversion of these non-renewable natural resources into other forms of capital can create the kind of wealth and sustainable opportunities that would allow a country to accelerate its transition from poverty to at least middle-income status and for its citizens to enjoy a better quality of life.

For low-income countries dependent upon aid, a policy shift towards what are commonly referred to as the extractive industries (EI) offers the prospect of an economy diversified away from subsistence agriculture, a balanced budget, a reduction in foreign debt, savings for a time when the resources decline, and an opportunity to develop new industries. For countries emerging from serious conflict or severe economic misfortune, a policy shift towards extractives offers the prospect of a fresh start. It is not surprising then that *the number of countries seeking to use oil, gas and mining resources to make such a transformation in their societies is*

¹ No less than one third of the membership of the International Monetary Fund (IMF) comprises 'resource-rich' countries, dependent on EI revenues for their future prosperity (IMF, 'Fiscal Regimes for Extractive Industries: Design and Implementation, p.6). The IMF has distinguished four groups of resource-rich countries: resource-rich developing countries (it identifies 29 of these); prospective natural resource-exporting low- or lower-middle-income countries (defined according to a World Bank classification) (it identifies 12); upper-middle-income resource-rich economies (it identifies 14), and high-income resource-rich countries (it identifies 8): IMF (2012). *Macroeconomic Policy Frameworks for Resource-Rich Developing Countries*. Washington D.C. Appendix 1, pp. 47-49. In earlier research, it identified over 35 developing states as 'petroleum-rich' and 20 states as 'mineral-rich,' based on the following criteria: (1) an average five year share of petroleum or mineral fiscal revenues in total fiscal revenues of at least 25 percent; or an average share of petroleum or mineral export proceeds of at least 25 percent. In most cases the observed shares are well in excess of 25 percent (IMF (2007). *Guide on Resource Revenue Transparency*. Washington, D.C.: IMF Media Services Division, Appendix I. Available at: www.imf.org/external/np/pp/2007/eng/051507g.pdf (last accessed 31 December 2013).

² For example, the Africa Progress Panel in their report, 'Equity for Extractives: Stewarding Africa's natural resources for all', Africa Progress Report 2013: "Far from being hostage to a non-curable resource curse, this generation of political leaders has an opportunity to harness resource wealth for a transformation in human development", p.8. Even for a high-income resource-rich, diversified economy, like the United States, the economic benefits of large-scale development of unconventional oil and gas resources have been spectacular.

*increasing significantly*³. There are now no less than 81 countries with economies that are driven by these resources⁴, and almost 80 per cent of them have below global average levels of per capita income.

Yet this rush of forward movement into EI is directed at a sector that has aroused far more controversy than most, and which offers to newcomers many cautionary signals. Contrary to expectations, a significant feature of natural resource development is that over half of the countries whose economies it has driven are *not* catching up⁵. Since 1995 they have failed to match the global average (unweighted) per capita growth rate. Among those which have an above-average economic growth in the long term, it can be argued that they have not always enhanced prosperity in the wider sense (productivity, resilience, connectivity, for example).

For many years the legitimacy of EI in relation to sustainability has been called into question. In a fair number of cases these industries have brought a surge of activity and investment which has triggered high expectations only to disappoint, as the benefits are retained by a few and the costs are borne by many. They have been said to bring about a 'resource curse'⁶. Development of the country in which the operations take place may not necessarily follow upon large-scale investment, at least not in the sense that it generates *long-term* development impacts. In some cases, the country may even become worse-off according to certain human development indicators, not least environmental ones. This has led some to conclude that the discovery and development of oil, gas and minerals is not a blessing at all or a source of opportunities to accelerate economic and social development.

This debate has been thrown into sharp relief by the sudden end of the long commodities boom which benefited resource-rich countries during the 2000s when oil and metal prices reached historic highs. The reversal in commodity prices has underlined the vulnerability of this industry to volatility, unpredictability and periodic shocks. Preparation for downward as well as upward swings is an essential task for any actual or aspiring resource-rich state.

³ Throughout the *Source Book* mining excludes petroleum products and natural gas, although these are also minerals and are 'mined'. This is a conventional definition which includes coal and uranium and which the *Source Book* follows.

⁴ McKinsey Global Institute (2013), *Reverse the Curse: Maximizing the potential of resource-driven economies*, McKinsey & Company. 'Resource-driven countries' are defined as those economies where the oil, gas and mineral sectors play a dominant role, using three criteria: (1) resources account for more than 20 per cent of exports; (2) resources generate more than 20 per cent of fiscal revenue; or (3) resource rents are more than 10 per cent of economic output.

⁵ McKinsey Global Institute (2013), *Executive Summary*, p.6.

⁶ The literature on this subject is vast, with the term being used by a large number of writers. It is discussed below in Chapter 2. One of the earliest examinations of the thesis is in Richard Auty's 'Sustaining Development in Mineral Economics: the Resource Curse Thesis' (1993). London. Routledge.

If a single lesson has been learned from this debate about experience to date, it is that a governance structure needs to be put in place in the host country that is directed at ensuring that short term benefits are not obtained at the expense of long-term sustainability, and should aim at a net positive impact.

Yet many citizens will find that the challenges of natural resource management are ones for which their governments are not well prepared. Moving forward is more than a matter of installing or building 'capacity'. It requires governments to understand how what is commonly described as 'good practice' is modified and improved by the latest research and comparative analysis, to test fresh approaches in their own unique contexts, and at the same time to persuade vested interests of the need for change. In practical terms, governments in countries that are already resource rich as well as those that have resource riches in prospect, will often inherit a legal and institutional framework for EI activity that needs to be reformed. In the latter group, however, there may be only a patchwork of contracts in place, hardly meriting the consistency and cohesion implied by the commonly used notion of a framework. Policies that envisage long-term resource-led development will often have to be designed from scratch.

In tackling these policy challenges, governments of resource-rich developing countries⁷ will quickly become aware of the current wide range of opinion and perspectives on resource-led development, bolstered by an impressive number of case studies, and volumes of empirical data. Some of this will caution them that the negative economic, environmental and social effects can outweigh the potential benefits of natural resource development. However, much of the advice they will be offered is likely to be informed by recent research which has shown that *there is nothing inevitable about negative or positive linkages*⁸. A growing body of opinion (discussed in this and in the following chapters) argues that discoveries of oil, gas or minerals can contribute positively to a country's overall agenda for social and economic development if the challenges of resource management can be successfully met within the constraints imposed by environmental considerations. Many of those challenges are now thought to lie within the institutional or governance frameworks of the countries themselves. In this light, governments and citizens in countries seeking to promote resource-led development will ask themselves: what should our priorities be and what choices are open to us?

⁷ By this is meant the low- and middle-income countries with exhaustible natural resources (such as oil, gas and minerals) that comprise at least 20 per cent of total exports or 20 per cent of natural resource revenues: IMF (2012). Macroeconomic Policy Frameworks for Resource-Rich Developing Countries, p.6.

⁸ There are many sources of evidence for this. For example, an IMF 'Background Paper' states: "A natural resource 'curse' is neither universal nor inevitable; growth may depend heavily on other factors, such as policies and the quality of institutions" (Macroeconomic Policy Frameworks for Resource-Rich Developing Countries – Background Paper 1, 2012), p.6. The 2013 Africa Progress Report in Note 2 above.

The first question they should address is whether oil, gas or other mineral exploitation is the best course of action or not. This is especially true in areas of high conservation value. There will be some situations where environmental (or social and cultural factors) are so significant, or occasions when the negative impacts cannot be reliably predicted, that oil, gas and mining must be considered an incompatible option and a precautionary approach should be adopted. Conservation can fit in not only where the extractive industries have no interest but on occasions the extractive industries must take due cognizance of other legitimate options.

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