

The resource curse: oil-based development in Central Asia

Mehdi Parvizi Amineh

Though Soviet centralised planning left the Caspian Sea littoral states of Azerbaijan, Kazakhstan and Turkmenistan poorly developed and struggling economically, their abundance of oil and gas resources brings hope for recovery. Turkmenistan is among the top 15 gas producers worldwide, while oil reserves in the Caspian Basin – comparable to those of the North Sea – have turned Azerbaijan and Kazakhstan into oil exporters.¹ The question is whether they will be able to use their income from oil and gas exports to transform themselves into modern, diverse industrial economies.²

Although it may seem that countries wealthy in natural resources should find it easy to develop economically, the experiences of some resource-based industrialising countries have proven otherwise, especially in the Middle East. The key to success appears to be economic diversification, as demonstrated by the post-1960 industrialisation of oil exporters Iran and Malaysia and non-oil exporters Turkey and South Korea. The latter three countries invested revenue generated by agricultural or oil exports back into agriculture, manufacturing, services and banking. Over time, restructuring sufficiently developed these sectors and allowed them to compete globally, thus creating economies able to withstand sectoral shocks. By contrast, Iran did not create a globally competitive manufacturing or service sector; while collusion between the government and major oil and gas companies, corruption and revenue mismanagement wasted income from oil and gas exports and made the economy dependent on them. This close relationship between Iran's oil revenues and its GDP seriously threatens economic growth by making it susceptible to 'Dutch Disease': a drop in the global oil price directly stunts economic growth, whereas a rise blunts the competitiveness of other exporting sectors under inflationary pressure that hinders diversification.

Politics as usual

An economy cannot truly diversify without the twin buttresses of political and economic institutions. Since the 1980s, the intensified neo-liberal economic nature of globalisation, the collapse of communism and the subsequent wave of democratization created an international political and economic setting that touted a market economy and democratic institutions as paramount to development. While a complete opening up to the world economy is probably not a wise course of action, there is no doubt that change can only be sustained through complementary democratic and economic reforms. Political reform without economic reform fails to sustain liberalisation; economic reform without political reform risks oligarchy. In the latter case, groups with no interest in political liberalisation seize control of resources and turn the country into a rentier state: not dependent on

taxing society for its income, the regime supports itself through, for example, oil and gas exports by state-owned companies. Independent from society, the state becomes indifferent to the country's development.

Unfortunately, the political reform attempts of Azerbaijan, Kazakhstan and Turkmenistan have not brightened the prospects for successful economic restructuring. That President Nazarbayev of Kazakhstan, President Niyazov of Turkmenistan and former President Aliyev of Azerbaijan were secretaries of their republics' communist parties during the Soviet era demonstrates what has happened in terms of post-independence political reform. In essence, the three countries exchanged communist rule for authoritarian rule. Although all three constitutions promise democratization, day to day politics show a different picture: opposition groups and parties are repressed, elections are manipulated, the independence of the judiciary is more than questionable and human rights are not a top priority. Kazakhstan might stand out for its open political debates and Azerbaijan for its press freedom, but all three regimes, instilled with old communist attitudes, remain authoritarian, draining their political legitimacy by engendering cynicism and distrust of all political activity.

Economically, Kazakhstan's reforms have led to a substantial shifting of assets to the private sector, an impressively expanding banking sector, the privatisation of electricity and increased foreign investment. In Azerbaijan, regulatory reforms to liberalise trade policy and privatise agriculture and small and medium-sized businesses were hindered by an inefficient public administration that entangled regulatory and commercial interests and bred corruption. Turkmenistan's economic reform has taken a reluctant and slow-paced approach in which most reforms are either negligible or purely rhetorical. All three countries remain dependent on oil and gas exports: after an initial, post-independence decline in GDP lasting until the mid-1990s, economic growth increased only because of oil and gas exports. Even though recent GDP has surpassed pre-independence levels, the World Bank estimates the percentage of the population living below the poverty line in Azerbaijan, Kazakhstan and Turkmenistan at 47, 20 and 50, respectively.

Resource curse

Against this backdrop, it is highly unlikely that diversification and industrialisation will succeed, except perhaps in Kazakhstan. It seems that resource abundance can actually hinder development and be more of a burden than a boon. The elitism and corrupt governance born of authoritarian rule easily leads to nepotism within clan and family circles and the 'resource curse': the paradox that countries with an abundance of natural resources fail to develop economically because

of governmental mismanagement of resource revenues. When wealth and power depend on one or a few resources, state elites often redirect state revenue to support these sectors in order to stay in power. In this sense resource revenues are not a solution to underdevelopment but integral to the maintenance of central governmental structures and self-enriching elites. The same elites often directly supervise – and effectively neuter – institutions ostensibly established to prevent such corruption, such as oil stabilization funds which ensure sufficient public funds when oil prices are low, and which supervise their use to finance infrastructural projects and promote non-oil industry developments.

For the curse to be lifted, centralisation must first be overcome. Centralisation around oil and gas export dependency increases the role of the state in the economy and job market and breeds inefficient production practices. Combined with political centralisation, which in Central Asia is promoting authoritarianism and limiting taxation of the upper classes, state income remains dependent on oil and gas revenues, which hinders the diversification of the economy.

Second, demand- and supply-induced scarcity must be addressed. Population growth, rising per capita income, higher levels of consumption, and technological change can increase domestic demand for fossil fuels to the point of scarcity. Supply-induced scarcity, meanwhile, refers to a decrease of the stock (or access to it) and inefficient use of supplies. Combined with the gradual depletion of resources, increasing demand and decreasing supply will lead to less revenue from exports as more supplies will serve domestic use. If financing economic restructuring depends on export revenues, development based on oil and gas income is uncertain.

Third, a deft sectoral investment strategy is required. Given global competi-

tion, oil and gas income reallocation is not straightforward. For example, how will the Caspian Sea states compete with Chinese manufacturing? Global economic and political linkages can help. Especially if supported by market and democratic reforms, an attractive climate for transnational companies and foreign direct investment can create opportunities and markets that could lead to economic diversification.

Finally, violence poses a serious challenge to economic development. Disputes over the control of oil and gas resources are all too familiar and often exacerbated by ethnic or religious hostility, terrorism, poverty and politics. Finding lasting solutions is always a daunting task. Education and the work of NGOs are necessary to create middle classes and minimise chances of radicalization.

A decentralisation model

A new path must be taken for Azerbaijan, Kazakhstan and Turkmenistan to avoid the resource curse and the fate of rentier statehood. An alternative policy model would involve the rearrangement of political relations by decentralizing state structures in favour of more regional constellations. This would promote democratizing tendencies and limit central government control over energy income by giving regions say over how oil and gas income-funded investment is spent. More decentralised energy income redistribution would promote economic diversification, give the private sector breathing space, and spur civil society to grow and assert its influence. Crucial to this model is the balance between the government and local centres of power to keep each other in check.

Although economic and especially political decentralisation reforms will face elite opposition, the model suggests a practical alternative to dealing with centralisation and the resource curse. The removal of both paves the way for the diversification of economic sectors to address demand and supply-induced



scarcity. This will not, however, solve all problems. High population growth, global economic competition and terrorism are not directly targeted, and it remains to be seen to what extent these policy suggestions can be applied to Azerbaijan, Kazakhstan and Turkmenistan. ◀

Notes

1. Azerbaijan and Kazakhstan export 211,000 and 997,000 barrels of oil per day, respectively. Proven oil reserves in billions of barrels for Azerbaijan, Kazakhstan and Turkmenistan are 7.0, 9.0 and 0.5, respectively, and proven natural gas reserves are 48.4, 67.1 and 102.4 trillion cubic feet.
2. Joachim Krause and Andrea Gawrich (Institute of Political Sciences, Christian-Albrechts University) and Matthias Luecke and Natalia Trofimenko (Institute of World Economics, Kiel Germany) research the same topic within the Razkaz (Political and Economic Challenges of Resource-Based Development in Azerbaijan and Kazakhstan) programme. See www.razkaz.uni-kiel.de

Mehdi Parvizi Amineh
Energy Programme Asia
International Institute for Asian Studies
m.p.amineh@uva.nl
www.iias.nl/epa

[advertisement]