

Blood Barrels
Why Oil Wealth Fuels Conflict
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Summary: The world has grown much more peaceful over the past 15 years -- except for oil-rich countries. Oil wealth often wreaks havoc on a country's economy and politics, helps fund insurgents, and aggravates ethnic grievances. And with oil ever more in demand, the problems it spawns are likely to spread further.

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The world is far more peaceful today than it was 15 years ago. There were 17 major civil wars -- with "major" meaning the kind that kill more than a thousand people a year -- going on at the end of the Cold War; by 2006, there were just five. During that period, the number of smaller conflicts also fell, from 33 to 27.

Despite this trend, there has been no drop in the number of wars in countries that produce oil. The main reason is that oil wealth often wreaks havoc on a country's economy and politics, makes it easier for insurgents to fund their rebellions, and aggravates ethnic grievances. Today, with violence falling in general, oil-producing states make up a growing fraction of the world's conflict-ridden countries. They now host about a third of the world's civil wars, both large and small, up from one-fifth in 1992. According to some, the U.S.-led invasion of Iraq shows that oil breeds conflict between countries, but the more widespread problem is that it breeds conflict within them.

The number of oil-producer-based conflicts is likely to grow in the future as stratospheric prices of crude oil push more countries in the developing world to produce oil and gas. In 2001, the Bush administration's energy task force hailed the emergence of new producers as a chance for the United States to diversify the sources of its energy imports and reduce its reliance on oil from the Persian Gulf. More than a dozen countries in Africa, the Caspian basin, and Southeast Asia have recently become, or will soon become, significant oil and gas exporters. Some of these countries, including Chad, East Timor, and Myanmar, have already suffered internal strife. Most of the rest are poor, undemocratic, and badly governed, which means that they are likely to experience violence as well. On top of that, record oil prices will yield the kind of economic windfalls that typically produce further unrest.

Oil is not unique; diamonds and other minerals produce similar problems. But as the world's most sought-after commodity, and with more countries dependent on it than on

gold, copper, or any other resource, oil has an impact more pronounced and more widespread.

THE CURSE

The oil booms of the 1970s brought great wealth -- and later great anguish -- to many petroleum-rich countries in the developing world. In the 1970s, oil-producing states enjoyed fast economic growth. But in the following three decades, many suffered crushing debt, high unemployment, and sluggish or declining economies. At least half of the members of OPEC (the Organization of Petroleum Exporting Countries) were poorer in 2005 than they had been 30 years earlier. Oil-rich countries that once held great promise, such as Algeria and Nigeria, have unraveled as a result of decades of internal conflict.

These states were plagued by the so-called oil curse. One aspect of the problem is an economic syndrome known as Dutch disease, named after the troubles that beset the Netherlands in the 1960s after it discovered natural gas in the North Sea. The affliction hits when a country becomes a significant producer and exporter of natural resources. Rising resource exports push up the value of the country's currency, which makes its other exports, such as manufactured and agricultural goods, less competitive abroad. Export figures for those products then decline, depriving the country of the benefits of dynamic manufacturing and agricultural bases and leaving it dependent on its resource sector and so at the mercy of often volatile international markets. In Nigeria, for example, the oil boom of the early 1970s caused agricultural exports to drop from 11.2 percent of GDP in 1968 to 2.8 percent of GDP in 1972; the country has yet to recover.

Another facet of the oil curse is the sudden glut of revenues. Few oil-rich countries have the fiscal discipline to invest the windfalls prudently; most squander them on wasteful projects. The governments of Kazakhstan and Nigeria, for example, have spent their petroleum incomes on building new capital cities while failing to bring running water to the many villages throughout their countries that lack it. Well-governed states with highly educated populations and diverse economies, such as Canada and Norway, have avoided these ill effects. But many more oil-rich countries have low incomes and less effective governments and so are more susceptible to the oil curse.

Oil wealth also has political downsides, and those are often worse than the economic ones. Oil revenues tend to increase corruption, strengthen the hands of dictators, and weaken new democracies. The more money the governments of Iran, Russia, and Venezuela have received from oil and gas exports, the less accountable they have become to their own citizens -- and the easier it has been for them to shut up or buy off their opponents. A major boom in oil prices, such as the one that took the price of a barrel from less than \$10 in February 1999 to over \$100 in March 2008, only heightens the danger.

OIL ON FIRE

For new oil and gas producers, the gravest danger is the possibility of armed conflict. Among developing countries, an oil-producing country is twice as likely to suffer internal rebellion as a non-oil-producing one. The conflicts range in magnitude from low-level secessionist struggles, such as those occurring in the Niger Delta and southern Thailand, to full-blown civil wars, such as in Algeria, Colombia, Sudan, and, of course, Iraq.

Oil wealth can trigger conflict in three ways. First, it can cause economic instability, which then leads to political instability. When people lose their jobs, they become more frustrated with their government and more vulnerable to being recruited by rebel armies that challenge the cash-starved government. A sudden drop in income can result in internal strife in any country, but because oil prices are unusually volatile, oil-producing countries tend to be battered by cycles of booms and busts. And the more dependent a government is on its oil revenues, the more likely it is to face turmoil when prices go south.

Second, oil wealth often helps support insurgencies. Rebellions in many countries fail when their instigators run out of funds. But raising money in petroleum-rich countries is relatively easy: insurgents can steal oil and sell it on the black market (as has happened in Iraq and Nigeria), extort money from oil companies working in remote areas (as in Colombia and Sudan), or find business partners to fund them in exchange for future consideration in the event they seize power (as in Equatorial Guinea and the Republic of the Congo).

Third, oil wealth encourages separatism. Oil and gas are usually produced in self-contained economic enclaves that yield a lot of revenue for the central government but provide few jobs for locals -- who also often bear the costs of petroleum development, such as lost property rights and environmental damage. To reverse the imbalance, some locals seek autonomy from the central government, as have the people in the petroleum-rich regions of Bolivia, Indonesia, Iran, Iraq, Nigeria, and Sudan.

This is not to say that petroleum is the only source of such conflicts or that it inevitably breeds violence. In fact, almost half of all the states that have produced oil since 1970 have been conflict-free. Oil alone cannot create conflict, but it both exacerbates latent tensions and gives governments and their more militant opponents the means to fight them out. Governments that limit corruption and put their windfalls to good use rarely face unrest. Unfortunately, oil production is now rising precisely in those countries where wise leadership is often in short supply. Most of the new energy-rich states are in Africa (Chad, Côte d'Ivoire, Mauritania, Namibia, and São Tomé and Príncipe), the Caspian basin (Azerbaijan, Kazakhstan, and Turkmenistan), or Southeast Asia (Cambodia, East Timor, Myanmar, and Vietnam). Almost all are undemocratic. The majority are very poor and ill equipped to manage a sudden and large influx of revenues. And many also have limited petroleum reserves -- just enough to yield large revenues for a decade or two -- which means that if they succumb to civil war, they will squander whatever chance they had of using their oil windfalls to escape from poverty.

DIAMONDS IN THE ROUGH

Since the early 1990s, the international community has developed an effective set of tools for ending insurrections. These include cutting off foreign aid to rebel groups, using diplomatic and economic sanctions to bring governments to the negotiating table, and deploying peacekeeping forces to monitor any agreements that might result from the pressure. Combined with the demise of the Soviet Union, such methods helped reduce the number of civil wars in non-oil-producing countries by over 85 percent between 1992 and 2006.

They have also been effective against insurgencies fueled by diamond wealth. In 2000, six diamond-producing states in Africa were trapped in civil wars; by 2006, none was. Much of this success is the result of sanctions that the UN Security Council started to impose in 1998 against so-called conflict diamonds -- diamonds sold by African insurgents or their intermediaries -- and the adoption in 2002 of the Kimberley Process, an agreement by an unusual coalition of governments, nongovernmental organizations, and major diamond traders to certify the clean origins of the diamonds they trade. After these measures were taken, rebels in Angola, Liberia, and Sierra Leone lost a key source of funding, and within a few years they were either defeated in battle or forced to sign peace agreements. In the mid-1990s, conflict diamonds made up as much as 15 percent of the world's diamond trade. By 2006, the proportion had fallen to one percent.

SEE-THROUGH

Curtailing rebellions in oil-producing states will be harder. The world's thirst for oil immunizes petroleum-rich governments from the kind of pressures that might otherwise force them to the bargaining table. Since these governments' coffers are already overflowing, aid means little to them. They can readily buy friends in powerful places and therefore have little fear of sanctions from the UN Security Council. In any event, the growing appetite of oil-importing countries for new supplies makes it easy for exporters to bypass such restrictions. The government of President Omar al-Bashir has used Sudan's oil sales to China to deflect diplomatic pressure from Western states asking it to stop the killings in Darfur. Myanmar's military government is following the same strategy: in exchange for Myanmar's selling its natural gas to China, Beijing is blocking tougher sanctions against the junta in the UN Security Council.

The best solution would be for rich countries to sharply reduce their consumption of oil and gas and help poor countries find a more sustainable path out of poverty than oil production. But the Western economies are so dependent on fossil fuels and the demand for oil and gas imports in China and India is growing so quickly that even the most aggressive push for alternatives would take decades to have any effect. In the meantime, a different approach is needed.

No single initiative will undo the oil curse and bring peace to oil-producing states, but four measures can help. The first would be to cut off funding to insurgents who profit from the oil trade. Oil-importing states could contribute by refusing to buy oil that comes from concessions sold by insurgents. Both the insurrection in the Republic of the Congo in 1997 and the 2004 coup attempt in Equatorial Guinea were financed by investors

hoping to win oil contracts from the rebels once they controlled the government. A ban on oil stemming from these transactions, much like the ban on conflict diamonds, could help prevent such rebellions in the future.

A second way to limit the effects of the oil curse would be to encourage the governments of resource-rich states to be more transparent. Their national budgets are unusually opaque; this facilitates corruption and reduces public confidence in the state, two conditions that tend to breed conflict. The Extractive Industries Transparency Initiative, an effort launched by nongovernmental organizations in 2002 and expanded by former British Prime Minister Tony Blair, encourages oil and mining companies to "publish what they pay" and governments to "disclose what they receive." This is a good idea, but it is not enough. Adherence to the EITI's reporting standards is voluntary, and although 24 countries have pledged to adopt them, none has fully complied yet. It is important that they do and that the effort to promote transparency be expanded. Oil-importing states, such as the United States, should insist, for example, that energy companies also "publish what they pump" -- that is, disclose from which countries their petroleum originates. This would give consumers the power to reward the most responsible companies. And that, in turn, would give companies an incentive to improve the conditions in oil-producing regions.

Another problem with the current standards is that even though exporting governments are pressured to disclose the revenues they collect, they are not expected to reveal how they spend the money. Oil revenues often vanish into the nooks of state-owned oil companies or into governments' off-budget accounts. According to the International Monetary Fund, between 1997 and 2002, the Angolan government accrued at least \$4.2 billion in oil receipts that it could not account for; at the time, Angola had the fifth-highest infant mortality rate in the world.

One possible remedy would be for the EITI (or a similar effort) to develop guidelines for the transparent allocation of all revenues from extractive industries. In his recent book *The Bottom Billion*, the economist Paul Collier suggests creating a "natural resources charter" that would set international standards for the governance of natural-resource revenues. The charter would help citizens figure out if their governments are properly managing the wealth. International credit-rating agencies could also use it to assess governments' creditworthiness, which would give governments a financial incentive to abide by the charter.

A third way to help oil-exporting states cast off the oil curse would be to help them better manage the flow of their oil revenues. Since the earliest days of the oil business in the mid-nineteenth century, oil prices have alternately soared and crashed. There is no reason to think this will change. But nor is there any reason to assume that because oil prices are volatile a government's oil revenues must be too. In a typical oil contract, the oil company is guaranteed a steady income and the government gets to keep most of the profits but also must bear most of the risk of fluctuating prices. This setup is exactly backward. International oil companies are skilled at smoothing out their income flows -- putting money aside in fat years to spend in lean ones -- whereas governments are terrible

at it. The terms of these contracts should be changed so that the oil companies bear more of the price risk than they do now and governments bear less.

Even with greater transparency and steadier revenues, many low-income countries simply lack the capacity to translate oil wealth into roads, schools, and health clinics. For these, the best way to steer clear of the oil curse may be not to sell oil for cash at all but to trade it directly for the goods and services their people need. The governments of Angola and Nigeria are now experimenting with this type of barter: they have awarded oil contracts to Chinese companies in exchange for the construction of infrastructure. Western oil companies have been reluctant to make similar deals, pointing out that they know little about building railroads and have trouble competing against state-owned enterprises in this arena, such as the Chinese oil companies. But they could easily team up with reputable companies that could carry out the work. And why stop at infrastructure? By forming partnerships with experienced service providers, oil companies could pay back host countries by, say, conducting antimalaria campaigns or building schools, irrigation projects, or microfinancing facilities. As more companies bid for such "oil-for-development" contracts, the terms of the contracts would become better for the governments. If inexperienced governments need help carrying out these auctions, the World Bank, or other international organizations, could provide technical assistance.

THE POWER OF PRESSURE

One obstacle, of course, is that some leaders have little interest in better governance: they are too busy profiting from corruption and crushing their opponents. In order to buffer the people of these countries from the mismanagement of oil wealth by their leaders, a fourth set of measures is called for. Laggard governments should be pressed to respect human rights and negotiate with rebels who have legitimate grievances. The U.S. Congress recently urged the State Department to consider withholding visas from corrupt officials who profit from the exploitation of their countries' natural resources. A visa ban might well be an effective tool: soon after Congress' call, the Cambodian government -- one of the world's most corrupt, according to Transparency International -- issued a bitter protest. The State Department should adopt the measure and enforce it broadly against leaders who are corrupt or ignore international human rights standards. And European governments should be encouraged to follow suit.

To avoid constraining measures from the West, some oil-producing governments have turned to national oil companies from China, India, and other developing states that do not concern themselves with their hosts' human rights practices. But pressure could also work against these companies, as many of them are publicly listed. Last January, the Dutch pension fund PGGM withdrew its \$54 million investment from the Chinese oil company PetroChina to protest the operations of PetroChina's parent company in Sudan; it is now considering a similar move against the Indian oil and natural gas company ONGC. Other investors should follow this lead until even companies that have not cared about such issues in the past agree to push for transparency and better human rights standards in the countries where they operate.

Helping oil-rich countries avoid violent conflicts and, more broadly, escape the oil curse will not be easy. Many of their governments are indifferent to the incentives offered by diplomats and development specialists. On the other hand, if the main stakeholders -- oil producers and energy companies, as well as international organizations, oil importers, and consumers -- do not find better remedies, a whole new set of countries will suffer the same tragic fate as Angola, Nigeria, Sudan, and, yes, even Iraq.

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