OPINION

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Why should resource-based economies diversify?

Despite its abundance of oil resources, Norway exhibits a viable management solution to the curse of the rentier state.

Masoud Movahed

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'The resource-based economies of the Middle East should solidify their manufacturing and industrial sectors through providing incentives, and nurturing their national sovereign funds,' writes author [AFP]

In the past five decades, the Middle Eastern oil producers have had the least manufacturing and industrial share in their Gross Domestic Product (GDP). Oil and gas nonetheless, continue to account for more than 60 percent of GDP in almost every resource-based economy in the Middle East.

However, amid the numerous resource-based economies worldwide, Norway has managed to stand out.

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It is the singular oil-producer country that has successfully embarked on economic diversification despite its abundance of oil resources. Suffice it to say, Norway remains the exemplar of a viable oil and resource management, upholding the country onto its path of industrial dynamism.

Albeit, the questions to ask are: 1) Why cannot the Middle Eastern oil-producers do the same? 2) Why have the mineral resources in the Middle East, precluded economic diversification? 3) Why has oil wealth often led to, at times, deindustrialisation or industrialisation merely in petrochemical sectors? 4) Is there a need, at all, to diversify the resource-based economies, given the ever-growing price of minerals, particularly oil?

Middle Eastern economists have been grappling with these questions since the discovery of minerals in the region.

They unanimously arrived at a simple conclusion. “Yes”. The oil producers of the Middle East should steer away from an oil-based economy for the following reasons: First, oil is a finite resource. Thus, alternative industries and revenues are necessary, given the inevitability of mineral depletion. Second, the world price of oil resources fluctuates, causing enormous budgeting discrepancies and consequently, negative impacts on overall growth rates. Third, modern mineral and oil refineries are highly technology-intensive. As a result, petrochemical and oil refineries require advanced vocational training and thus, do not serve as ample employment opportunities for the indigenous manpower. Hence, oil and gas industries impede the notion of “learning by doing”, which offers on-site training for labours. Fourth, diversification provides other investment opportunities in the non-energy and private sectors to create more productive employment.

A vibrant private sector provides incentives for individual actors to specialise, innovate and ultimately produce, which ultimately increases employment.

Abundance of capital

It is noteworthy that the detrimental impacts of a resource boom are not endemic to the oil producers of the Middle East alone, which did not have solid industrial sectors prior to the discovery of oil.

That is to say, a resource boom can be detrimental to the manufacturing and industrial sectors, regardless of the pre-existing status. For instance, the Netherlands, a western industrialised democracy, during the 1960s discovered massive Sclochetern gas fields in the Groningen province, which resulted in the rapid exploitation of gas resources.

Shortly thereafter, the Netherlands became a significant net exporter of natural gas, witnessing an unprecedented boom in the country's aggregate revenues. Though receiving titanic revenues from the gas exports, the manu-

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term internal and external policies to adequately compensate for the resource depletion."

This phenomenon was coined the "Dutch Disease". Economists subscribe this adverse impact of the natural resource boom on the manufacturing sector and the temporary appreciation of the real exchange rate.

Since the booming energy sector, pumps immense revenues into the market, the domestic inflation rate increases compared to the world inflation rate.

As a result, profits for exporters reduce, as wages and input prices increase more expeditiously than the world price of exporters. Subsequently, the production of the export producers wanes, stemming less aggregate production and employment. Moreover, the domestic producers have fewer incentives to produce as the surge in resource exports cause an appreciation of the real exchange rate of the country compared to others.

Simply put, since revenues generated from marketing oil are received in dollars, the current currency of the country becomes stronger compared to other nations, whereby making the non-oil sector exports less lucrative and competitive, making the non-oil sector more expensive.

The very abundance of capital-intensive resources, coupled with the comparative advantage of production, result in the erosion of the non-oil sector.

A country that derives almost all of its revenues from a depleting mineral resource should adopt long-term internal and external policies to adequately compensate for the resource depletion. Oil and gas resources in Middle Eastern states will be the heritage of generations to come.

Therefore, the governments of these states must ensure the sustainability of their mineral resources, accumulate foreign assets and invest in productive activities in the domestic economies. This approach has proven successful in Norway.

The Norwegian miracle

Norway has a prosperous mixed economy with a vibrant private sector and is known for its efficient social safety networks. It is hailed for witnessing an oil boom and not suffering from the "oil curse" and "Dutch Disease". Not only has the Norwegian oil management and investments been detrimental to the manufacturing and industrial sectors, but very much beneficial to the domestic production cycle.

Norway's successful oil management is down to one man. Farouk Al-Kasim, a young Iraqi geologist and a UK-educated oil export, saved the Norwegian economy from the "oil curse".

"The Norwegian oil management model can be conceivably followed by the resource-based … **dependence on minerals, and launch a great economic leap forward."**

… economy would have suffered from the same paralysing disease the Netherlands did in the course of the 1970s.

Instead he proposed that the government should monitor the incursion of oil revenues to impede destruction of non-energy sectors. Once in an interview, Al-Kasim stated: "Norway also managed to avoid the so-called 'oil curse', not putting the huge revenues directly into the economy. The decision was taken to invest these abroad, rather, and use just what could be absorbed. This resulted in the four percent fiscal rule".

Prior to examining why oil did not become an obstruction to industrial and manufacturing sectors, it would be very instructive to look at the causal mechanisms of the dichotomy of "oil wealth" and "deindustrialisation".

As shown previously, the flood of money generated form the oil and gas revenues to the domestic economy inflates the currency, leading to price increase and higher cost of production.

By contrast, Norway held almost all of its revenues in a giant national sovereign account known as Norway's "Pension Fund". It holds roughly $600bn, which constitutes world's largest sovereign wealth fund.

Through controlling the flood of oil money, Norway precluded the negative impacts of oil boom on its manufacturing and industrial sectors. Equally importantly, Norway invested the oil revenues in productive sectors of industry.

Although much empirical work remains to be done in order to establish the importance of the Norwegian oil management, it is evident that Norway has learned a significant lesson from the Dutch Disease.

The resource-based economies of the Middle East too, instead of heavy reliance on the easy-earned money from oil, should solidify their manufacturing and industrial sectors through providing incentives, and nurturing their national sovereign funds.

The experiment of economic diversification though cultivating productive investment in manufacturing and industrial sectors is proven successful in Norway. The Norwegian oil management model can be conceivably followed by the resource-based economies of the Middle East to reduce their dependence on minerals, and launch a great economic leap forward.

Controlling the inflow of oil revenues into the domestic markets and providing protection for the domestic firms in the forms of subsidies, the Middle Eastern oil producers can offer incentives to strengthen the domestic production. Focusing primarily on services such as commercial banks, tourism and real estate, though proven lucrative, cannot plausibly be the remedy for a viable economy in the long term.

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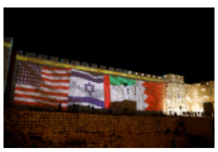

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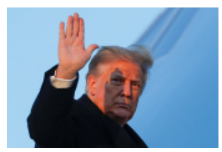

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