

Russian Oil

Russian Oil
Blessing or a
Curse?

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Introduction

International Energy Outlook¹ predicts worldwide energy demand to increase by 2.1 percent on average annual basis from 2004 to 2030 when considering a high economic growth case. In a lower economic growth situation energy demand is predicted to grow by 1.4 percent.

The greatest contributors to world energy demand are China, other Non-OECD Asia, India, East Africa and Central and South America.

A decade ago, Russia was kneeled under the pressure of debts and low foreign exchange reserves. Currently, there is no outstanding debt to the IMF², GDP per head is \$9000 compared to \$2000 in 1998. At the same time there is \$480 billion in foreign exchange reserves. Also, a

¹ International energy outlook, (2007), U.S. Department of Energy Washington, DC 20585: Appendix B and C.

² The International Monetary Fund

stabilization fund, now holding over \$150 billion is set up to insulate the economy from the volatility of raw materials and absorb shocks. Excess gas and oil revenues fuel the Russian economy, which is highly dependent on its oil and natural gas exports.

Antonio (2005), concluded that federal budget revenues rise by 0.35 percent of GDP – \$3.4 billion, for every \$1 increase in oil prices. Export revenues are dominated by raw materials like oil, natural gas and metals, which account for two-third of Russia's export income. Further estimates of the IMF and the World Bank suggest that the oil and the gas sector only, represented about one-fifth of Russia's GDP over 2005.

Moreover, these sectors generated over 60 percent of export revenues in 2007,

and were responsible for 30 percent of Russia's foreign direct investments.

Worldwide demand of fossil fuels increases, and prices of oil reach record levels³.

As for the Russian energy supply; as long as the prices of energy are profitable, Russia will continue supplying the world with these scarce resources.

Economies, where natural resources account for more than 10 percent of the GDP and 40 percent of the exports, can be considered as resource-based. In the past decade, Russia's dependency on oil export has grown significantly.

³ In 2000, one barrel of oil only cost \$20. As of today, one barrel of oil is priced at over \$130

A study by The Brookings Institution⁴ investigates the position of Russia in the world energy markets.

An R squared⁵ value of 0.79⁶ was reported between GDP change and Oil export revenue change, over the period of 1997 and 2006. This confirms the high dependency of the Russian economy on oil revenues.

Concerning thoughts arise about the sustainability of the Russian economic growth; Resource based economies are highly dependent on the export revenues derived from natural resources. Because commodity prices often fluctuate, revenues in a resource based economy are sensitive to changes in prices.

⁴ The Brookings Foreign Policy Studies. 2006, the *Russian Federation*. Energy Security Series

⁵ R-squared is a Statistical measure, indicating how well a regression line approximates real data points.

In this case, how well GDP change, is explained by oil export revenue change. R squared of 1.0 indicates a perfect relation.

⁶ See figure 10 in appendix A for an illustration of this regression.

Bush, (2005) warned for the probable curse of high oil prices for the Russian economy – highlighting the warnings of a possible resource curse which could strike the Russian economy.

Presented as “Russia’s economic dead end” a recent article obtained from BusinessDay⁷ states that – Russian economy has ignored the advice from the World Bank to invest in other “industries, start-up companies and infrastructure”. Furthermore it states that the existing stabilization fund can cushion possible energy price falls only for a short period of time. The article suggests that this way of operating an economy may turn against Russia because of the appreciated ruble and increased wages.

⁷ BusinessDay, (2008). *Russia’s economic dead end.*

With the aim of investigating whether the case of a resource curse applies to the Russian economy. Taking in account the criticism and the praise reflected upon Russia with regard to its policies. The following research questions are set up.

Main Research Question

Is Russia suffering under a resource curse?

Sub-Questions:

- 2) What is the resource curse, and which symptoms are linked to the Resource Curse?
- 3) Which of the symptoms identified with the resource curse apply to the Russian Federation?
- 4) What are the suggested solutions for solving the problems identified in section 3?