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Research Report

Economic and Social

The Question of the over-reliance on fossil fuel exports in underdeveloped economies

30 YEARS Haileybury MUN 30 YEARS

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Background

In the 21st century, most underdeveloped countries in the world are becoming very dependent on fossil fuel exports to drive their economies. Fossil fuel energy sources - coal, oil, and natural gas - comprised about 81.5% of the world's primary energy usage. It usually begins when poorer nations find sufficient oil and natural gas reserves, which seem to be a ticket to prosperity in the short term but in reality can do severe harm to a nation's economy as it leaves it exposed to significant risks such as the volatility of world oil prices and the world's effort to decrease the reliance on non-renewable fuels.

For example, Nigeria derives more than 80% of its government revenues from oil, making it very vulnerable to changes on the world market. This has hampered economic diversification, as there has been such a strong government focus on oil infrastructure resulting in high unemployment and poverty. Venezuela was once considered one of the richest countries in Latin America based on its oil, and now it has been plunged into economic meltdown due to political unrest and mismanagement of oil revenue. These potential issues were greatly exaggerated by the slump in global oil prices in the 2010s, indicative of the vulnerability a country goes into with its reliance on one commodity for the economic stability of the country. Iran and Iraq face similar burdens, given that their economies were deeply affected by sanctions and regional conflicts limiting the capacity to use resources for sustainable growth. Also, the Syrian economy, before the start of the civil war, was at least partly dependent on oil exports, but conflict and generalised destruction have left its economy in tatters. All these cases share something in common: heavy dependence on the export of fossil fuels acts as a damper toward economic progress, creates political problems, and eventually places countries at the mercy of forces beyond their control. The same dependence becomes quite understandable with regard to what drives it. Only in this way can we appreciate the critical role of economic diversification in these countries. Investing in other sectors-manufacturing, technology, and renewable energy-increases one's buffer against commodity market volatility and opens up pathways to more stable and inclusive economic growth.

Definition of Key Terms

Economic Diversification: The process of expanding an economy's range of activities and industries to reduce dependence on a single economic sector or resource. In underdeveloped economies, diversification helps mitigate risks associated with reliance on volatile commodities like fossil fuels.

Resource Curse: A phenomenon where countries with abundant natural resources, especially non-renewable ones like oil and gas, tend to experience less economic growth and poorer development outcomes compared to countries with fewer resources. This paradox often results from mismanagement, corruption, and an over-reliance on one primary export.

Commodity Price Volatility: The tendency for the prices of commodities, such as fossil fuels, to experience unpredictable and significant fluctuations. For countries dependent on fossil fuel exports, these price swings can lead to economic instability, budget deficits, and social challenges.

Revenue Dependence: A condition in which a country's national income relies heavily on a specific source, such as oil or gas exports. High revenue dependence on fossil fuels can limit a government's ability to fund other sectors, making the economy more vulnerable to market and geopolitical changes.

Overview of Current Issue

Creation of Economic Vulnerabilities

Success with fossil fuel exports has proved to be a blessing and a curse for many underdeveloped countries across the world. While oil and gas exports can be a very crucial resource that often enriches a country and sustains the local fossil fuel reserves, this source of revenue also encompasses serious risks. Many countries, such as Nigeria, Venezuela, Iran, Iraq, and Syria, have through history shown how perilous it is to be heavily dependent on one industry. These countries are severely hit whenever the price of oil falls, leading to budget crises, a decrease in public spending, and increasing poverty. Dependence that is so heavy makes diversification or steady growth difficult to achieve in such economies. Even when the price of oil is high, the generated wealth hardly reaches the larger population because of corruption and inefficient distribution; the benefits remain pegged at a small percentage of the population. These countries, therefore, get caught up in the vicious circle of economic unpredictability whereby fluctuations in revenues may engender debt, inflation, and even political turmoil. Besides, overdependence can bring about an increase in debt of another country, trapping it into a no-end vicious cycle of poverty.

Social and Political impacts

On a broader perspective, however, such overdependence on the export of fossil fuel has a lot of implications aside from purely being economic. More often than not, in many countries, oil revenues directly relate to political power, which encourages corruption at the expense of transparency. In the case of Venezuela, for example, which has seen a disproportionate dependence on oil, a collapse in prices has substantially aggravated political instability and humanitarian crises affecting humans. In Nigeria, for instance, sabotage and violence by militant groups in oil-rich areas are symptomatic of deeper grievances with social and environmental impacts. As the attention to oil revenue mounts with the volatility of its prices, probably threatening to shrink government budgets, basic social services like education, health, and infrastructure have been overlooked to retain poverty and hinder human development. Due to the fact that the whole world is beginning to shift towards a renewable and non-fossil fuel energy direction, these countries are facing tested challenges in adapting to the change since their economies largely emanate from oil. This overdependence suppresses progress and simultaneously leaves them out in the open when it comes to future shocks and global pressures.

Relevant Countries and Organisations

Nigeria

Nigeria is a very good example of the country that faces all the challenges brought about by depending on the exportation of fossil fuel. It accounts for over 90% of Nigeria's export revenue and contributes to approximately 60% of government income. This overdependence by the economy is so sensitive that it is drastically affected by changes in world oil prices. The revenue from oil dramatically fell in 2014 and plunged Nigeria into an economic recession, with its GDP shrinking by 1.6% in 2016. While oil riches have spurred some infrastructure projects and social programs, graft and incompetence have ensured that these rents do not trickle down sufficiently. As estimated by the Nigerian National Bureau of Statistics, more than 40% of the population still lives beneath the poverty line, a fact that aptly shows how rarely oil profits reach wider swathes of society. While recent efforts at diversification, in the form of increased investment in agriculture and technology, show potential, the contribution of the non-oil sector to total exports is still about 10%.

Venezuela

Venezuela well illustrates the terrible risks of excessive dependency on fossil fuels, especially oil. It reached a peak at about 98% of their export earnings and around 50% of the nation's GDP. When, in the 2010s, world oil prices crashed, government revenues collapsed along with devastating economic consequences: in the realm of hyperinflation, estimated at over 300,000%, according to the International Monetary Fund in 2019. That sparked broad food, medicine and other basic goods shortages, shoving more than 90% of the citizenry into destitution, according to ENCOVI, a Venezuelan living conditions survey. Corruption feeding the crisis-in some cases, billions of dollars in oil revenues were mismanaged, diverted, or lost to fraud-leaving little invested in sustainable economic initiatives. Whereas oil dependency once was the fuel to Venezuela's wealth, today it remains a driver of continued economic and humanitarian crisis in the country.

Iran

Another clear example of the vulnerabilities brought about by overdependence on fossil fuel export is that of the economy of Iran. Oil and natural gas make up nearly 80% of the total export revenue and comprise over 40% of the government budget revenues. Overdependence of the economy on a single commodity has made it susceptible to external constraining factors, which include fluctuating oil prices and sanctions. For example, Iran's oil exports nosedived from 2.5 million barrels a day to less than 400,000 a day between 2018 and 2020, in consequence of the re-imposition of US sanctions. Government revenues thus suffered greatly, and this decidedly sapped economic stability. The resulting squeeze has driven inflation rates above 40% a year and unemployment toward estimated highs above 10%. Iran has announced a set of initiatives to diversify its economy, which even include expanding non-oil exports to its neighbours; still, such progress has been constrained by regulatory challenges and ongoing geopolitical tensions.

Possible Solutions

Promoting Economic Diversification

Encouragement of economic diversification is among the most feasible remedies for overdependence on fossil fuel exports. Economies that are heavily reliant on oil and gas should develop policies that attract investment in other sectors, such as agriculture, manufacturing, and renewable energy. For example, developing incentive schemes for SMEs may stimulate innovation and job creation outside of the fossil fuel sector. The governments' investments in infrastructure and education will facilitate the development of skills that create enabling environments for citizens to find employment in other industries. Interaction with international organisations and development agencies may also promote knowledge and technology transfer, which facilitates diversification. An end result of a diversified economy: it is less vulnerable to changes in oil prices and is more sustainable.

Increasing governance and transparency

Improvement in the sphere of governance and transparency in both oil and gas industries is highly essential to ensure revenues from fossil fuel contribute to national development. Robust regulatory frameworks can be implemented that make transparent reporting of revenue flows pre-eminent and help combat corruption and mismanagement. For instance, acceding to standards such as the EITI makes information available in resource management and revenue allocation to all stakeholders, including the public. Besides, a government may make independent oversight bodies that manage the distribution of oil revenues and invest them in social programs, infrastructure, and economic development projects. The implication of these actions is that accountability and, hence, public confidence are enhanced to ensure that benefits accruing from a fossil fuel resource are maximised along with the risks from overdependence on the same.

Transitioning to renewable energy resources

Investing in renewable energy represents one avenue through which the underdeveloped economies may find an abiding solution to get rid of dependence on fossil fuel. Transitioning into renewables will help nations overcome the economic risks bound to volatility in fossil fuel markets, besides ushering in environmental sustainability. Countries may use the availability of existing energy infrastructure to tap solar, wind, and hydroelectricity in order to widen their energy mix. International cooperation can be highly instrumental in this transition, whereby the developed countries provide resources and expertise to enable underdeveloped countries to invest in renewable energy technologies. Mechanisms such as the Green Climate Fund make access to funds available for projects proposed to promote energy security and reduce dependency on fossil fuel supplies. While adopting renewable energy, underdeveloped economies can ensure a more sustainable and resilient future.

Relevant Websites and Articles

The World Bank in Nigeria

This page provides an overview of Nigeria's economy, including its reliance on oil exports, economic challenges, and statistics related to poverty and government revenue. It highlights the impact of oil dependency on Nigeria's economic stability.
https://www.worldbank.org/en/country/nigeria/overview

The Venezuelan Exodus: An Unprecedented Economic and Humanitarian Crisis

This article discusses Venezuela's economic crisis, focusing on the effects of the oil price collapse, hyperinflation rates, and the humanitarian impact of the country's reliance on oil revenue.
https://www.elibrary.imf.org/downloadpdf/view/journals/087/2022/019/article-A001-en.pdf#:~:text=Venezuela%20experienced%20one%20of%20the,in%20almost%20half%20a%20century.

U.S. Energy Information Administration (EIA): Iran

This page provides information about Iran's energy sector, including statistics on oil and gas production, export revenue, and the effects of sanctions on the economy.
https://www.eia.gov/international/analysis/country/irn/background

Extractive Industries Transparency Initiative (EITI)

The EITI website outlines standards for transparency in the extractive industries, promoting accountability and good governance in countries dependent on oil and gas revenues. It details initiatives and outcomes from countries that have implemented EITI standards.
https://eiti.org

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