Kenya's Paradoxical 'Resource Curse'

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CHAPTER 1.0 – Introduction

Kenya's Great Rift Valley has long been dubbed 'the cradle of mankind' since archeologists first uncovered the fossils of early humans there in the early 1900s. Yet in March 2012, it was another discovery that brought attention back to the valley. Then president, Mwai Kibaki, hailed the unearthing of oil in the valley as a "major breakthrough" (BBC, 2012). Tullow Oil, the company that made the initial discovery, has so far confirmed the presence of 1.7bn barrels in the area, but estimates suggest the final reserves could amount to approximately 20bn barrels. If confirmed, this would transform Kenya from one of the most resource-poor countries in Sub-Saharan Africa, to one of its richest, with oil reserves second only to Nigeria's 37bn barrels (IFA, 2013). Rostow (1960) argued that the exploitation of natural resources was a pre-condition for economic 'take-off' within the developing world, and it is clear to see the massive wealth that can be generated by capitalising on oil reserves. However, there is also an abundance of evidence pointing towards a much more complex relationship that exists between resource endowment and development.

It seems almost counterintuitive to consider natural resource wealth as a 'curse' for development. However, the rapid growth of the resource-poor East-Asian Tigers alongside the economic woes of the resource-rich Latin American nations that led development theorists to investigate further the relationship between resources and development. This led to the evolution of the 'resource curse' concept, which attempts to explain the puzzling evidence that resource-rich countries regularly performed worse than their resource-poor counterparts. This paper explores this seemingly paradoxical 'resource curse', examines its causes, and applies the concept to the case of Kenya. It discusses the potential economic, political and social challenges that Kenya is likely to face, and the policy options at its disposal to protect against the 'curse'.

Kenya does not have to look far to see the negative impacts oil can have, as high profile problems in nearby Nigeria, Angola and Sudan all highlight how oil can hinder rather than help a country. Tullow Oil also discovered oil in neighbouring Uganda in 2006, but disputes with the government have left Uganda "yet to sell even a barrel" (Ugandan Independent, 2014). Arguably the only success story to emerge from Africa emanates from Botswana, where since the discovery of diamonds, the country has become "one of the fastest growing economies in the world and moved into the ranks of upper-middle income countries" (World Bank, 2013). Kenya is expected to earn 'middle-income' status in September 2014, sixteen years ahead of the 2030 goal set in its Vision 2030 development blueprint (Business Daily Africa, 2014), but the discovery of oil and resulting potential for the 'resource curse' may present a real threat to Kenya's rise.

The exploitation of the recently discovered vast oil reserves in Kenya is intriguing as the resource curse seems particularly prevalent within the African continent. The second section of this paper discusses the existing evidence and literature associated with the resource curse, whilst the third section of this paper discusses the economic explanations for the challenges that resource wealth can present. These include 'Dutch Disease' and commodity price volatility, and it is considered how these may affect Kenya. As policy solutions exist for these economic challenges, it is argued that the resource curse is not an economic inevitability, but the result of the political difficulty surrounding effective policy implementation. Therefore, the fourth section discusses the political explanations for development difficulties, such as political myopia and the 'rentier-state' concept, and considers their relevance within

Kenya. The fifth section focusses on research highlighting the potential for resource wealth to trigger civil conflict, and the likelihood of this occurring within Kenya. The paper concludes that whilst Kenya faces multiple challenges in preventing the 'curse', such as corruption and ethnic tensions, it is uniquely positioned to do so, due the strength of its existing bureaucracy and institutions.

CHAPTER 2.0 – The Resource Curse

The resource curse concept was first proposed by Auty (1993) when he noted that a "growing body of evidence suggests that a favourable natural resource endowment may be less beneficial…than the conventional wisdom might suppose" (p.1). Sachs and Warner (1995) supported Auty's thesis, as they identified a clear "negative, statistically significant" correlation between resource endowment and economic growth (p.15). Examining global growth rates between 1971-89, they highlighted how resource-poor East-Asian 'Newly Industrialised Countries' (NICs), such as Taiwan and South Korea, had surged ahead in economic performance against resource-rich countries such as Mexico and Nigeria. Gylfason (2001) noted that only four of 65 "natural resource-rich" countries managed to maintain a per capita GNP growth rate higher than 4% between 1970-98 (p.848). Gylfason also noted how OPEC nations as a whole suffered an average 1.3% GNP per capita decrease between 1965-98, alongside an average 2.2% increase among low and middle income countries (p.848). There was now a wealth of evidence to challenge conventional assumptions that resource abundance was a blessing for developing nations.

The evidence shows that the curse is not bound to specific resources, or to any particular regions, but it is also clear that the detrimental effects of resource endowment are far from absolute. Norway has flourished thanks to their oil reserves, whilst Nigeria near collapsed. Botswana's diamonds helped them to rapidly advance their development, whilst the diamonds of Angola fuelled a bloody civil war. There are various examples of countries developing because of, not in spite of, their resource wealth, with Botswana's case serving as a reminder that it is not just developed nations that can benefit. The World Bank (1994) noted that five of the top eight resource-rich nations were also amongst the 15 nations with the highest incomes. The resource curse is therefore seemingly not an inevitability, but a significant global trend. In understanding whether it is possible for Kenya to 'buck' this trend, we must first understand the explanations for the negative effects on development resource wealth can cause to arise. In the next section, the potential economic effects of resource wealth, and how these may impact upon Kenya, are considered.

CHAPTER 3.0 – The Economic Curse

This section of the paper examines how the discovery of oil may influence Kenya's development, by considering some of the key economic causes behind the resource curse. Looking primarily at 'Dutch Disease' and commodity volatility, it argues that these economic threats are not inevitable for Kenya, and that they can be avoided.

3.1a – Dutch Disease

Sachs and Warner (1995) have argued that 'Dutch Disease' is the primary cause of the resource curse (p.22). Coined by The Economist (1977, p.82), 'Dutch Disease' was the phrase used to describe the decline in manufacturing in the Netherlands after the discovery of vast natural gas reserves in 1959. To best understand how this process occurs, consider that an economy is split into three sectors; non-traded goods (the service sector); resource-based traded goods and manufactured (or agricultural) traded goods. The discovery of large quantities of natural resources inevitably leads to a 'boom' in the resource-based traded goods sector, which has a two-fold impact on the macroeconomy of a country.

Corden and Neary (1982) label the first effect as the "resource movement effect" (p.7). The booming resource sector requires increased support, and draws capital and labour away from the other sectors, primarily the manufacturing sector. Manufacturing and agriculture are resultantly weakened by this loss of resources, termed "direct de-industrialisation" (p.7). However, the sector is further weakened by a second impact of the booming resource sector, the "spending effect", which causes "indirect de-industrialisation" (p.9). The revenue brought in from the resource sector leads to an increased demand for non-traded services, which causes an increase in the real exchange rate (the relative price of non-traded goods in terms of traded goods). Increased demand causes the price of non-traded services to rise, but as the value of manufactured goods is set on the international market, these prices remain the same. Therefore, exports become more expensive, whilst imports become cheaper. A country is resultantly left with a weak traded goods sector, as goods become too expensive to be sold on the global market. This leaves the economy heavily reliant on the resource sector, and exposed to external shocks.

Nigeria offers perhaps the greatest example of the dangers of 'Dutch Disease', and an important one for Kenya to consider as potentially the only African nation with greater oils reserves than themselves. Martin and Subramanian (2003) have noted the extent to which Nigeria's booming oil sector rapidly disrupted their agricultural and manufacturing sector. Cash crop production "saw a decline in output of about 75 percent between 1970 and 1981" (p.584). Resources were diverted towards the high-yielding resource sector, and the government in the 1970s, confident of the returns to come from oil income, began to borrow heavily to fund public spending and grand investment plans. However, the 1980s 'Oil Glut' resulted in a collapse in the value of oil, driving Nigeria's fiscal budgets into deficit. Nigeria had to borrow heavily to support their existing spending, and so marched unimpeded into debt. The resource sector Nigeria relied on could no longer support their spending, whilst the traded goods sector was uncompetitive and agriculture weakened. Nigeria was left heavily indebted, and almost entirely dependent on food aid (Otaha, 2012, pp.82-83). But what potential is there for Dutch Disease to affect Kenya?

3.1b – Dutch Disease in Kenya?

Kenya's oil reserves, at potentially the second largest in Africa, are certainly sizeable enough to create a huge boom in this sector of the economy. However, there are examples of countries, notably Norway, avoiding Dutch Disease. How at risk is Kenya, and how can it learn from Norway? The Dutch Disease concept proposes that capital and labour will flow from the manufactured and agricultural goods sector into the resource-based sector, in what is known as the 'resource movement effect'. The vast potential income to be made from Kenya's oil makes it almost inevitable that capital will flow into the sector, although the majority is likely to be in the form of FDI and may not be drawn from other sectors. But is Kenya likely to see a dramatic shift in labour?

The Dutch Diseases theory seemingly rests on an assumption of full employment, in that new jobs in the 'booming' sector will have to be filled by workers that leave the 'lagging' sector. However, Kenya's unemployment rate is currently estimated to be approximately 40% (CIA World Factbook, 2014a). This shows that there are millions of citizens, a labour surplus, able to fill new vacancies in the resource sector, or those in the traded goods sector should labour be diverted. Corden (1984) has also argued that technological advances in the hydrocarbon and mineral industries mean they tend to employ few people (p.362). The 'resource movement effect' therefore may be exaggerated by Dutch Disease. This could indicate that the dangers of 'direct de-industrialisation' will not pose a strong threat to Kenya, but 'indirect de-industrialisation' caused by an increase in the real exchange rate may constitute a stronger challenge.

Should Kenya suffer from the 'spending effect', and so an increase in the real exchange rate, the outlook could be bleak. This effect leaves manufacturing and agriculture weak and uncompetitive in the international market. Currently 70% of Kenya's employed labour force work in agriculture, primarily producing cash crops (CIA World Factbook, 2014a). Bevan et. al. (1998) has shown how Nigeria's oil wealth triggered massive urban migration, which dramatically reduced the size of the rural labour force. This led to a fall in production and so a rise in food prices (p.185). If the same were to happen in Kenya, the effects could be dramatic. 70% of Kenya's labour force could find their jobs at risk as agricultural products become too expensive for the global market, and any job losses would add to the existing 40% unemployment. The Kenyan position would then be all too similar to Nigeria's, with the government required to support a huge unemployed population, at a time of rising food prices. The government can

only afford to do so as long as they see successful income from the resource sector. Should a shock to the price of oil occur, poor fiscal planning could catapult Kenya into the red.

However, the case of Norway shows us that Dutch Disease is not a universal experience, and there does exist a policy solution to guard against a real exchange rate increase. Norway created a sovereign wealth fund (SWF), a state-owned investment fund, where approximately 80% of oil income is deposited and cautiously invested in stocks and bonds internationally. This reduces the impact of the resource income on the price of non-traded goods, and prevents a dramatic rise in the real exchange rate. This process of 'sterilisation' has created a fund which, as of 2012, is worth over $600bn (Oil In Uganda, 2012), and allows the state flexibility in managing its economy. Any shortfalls from price shocks can be covered by dipping in to the SWF. Encouragingly, Kenyan central bank chairman Mbui Wagacha has announced that this will be a policy Kenya will implement (Bloomberg, 2014). The existence of a political solution to the challenges of Dutch Disease suggests that the problems associated with the resource curse may arise from the difficulty in implementing appropriate policy to mitigate the challenges of the 'disease'. These political challenges will be considered in the third section of this paper.

3.2a – Commodity Prices

An explanation for the resource curse was indadvertedly provided by Prebisch (1950) and Singer (1950) when they identified a historically increasing gap between the value of resources and the value of manufactured goods. This steady decline in the 'terms of trade' is caused by the 'income elasticity of demand' for manufactured goods being higher than that of primary commodities. Frankel (2012) explains, "for every one percent increase in income, the demand for raw materials increases by less than one percent" (p.4). Therefore, exporting resources results in worse economic performance than exporting manufactured goods. Free trade proponents argue that a country must specialise in its comparative advantage to succeed in the international market, but this evidence suggested it was a poor decision to specialise in your comparative advantage if the advantage was resource exploitation. Prebisch (1950) therefore advocated protectionist policy arrangements, to ensure that a country could develop a competitive manufacturing sector (p.4), as focussing on resources would resign a country to an ever-declining economic status. This fuelled much of Latin America's controversial 'Import Substitution Industrialisation' (ISI) policies between 1950-80, where foreign imports were replaced with domestic products, in a bid to remove external reliance and promote the domestic manufacturing and agricultural industry.

However, more current research has questioned the idea of a consistent downward trend in the price of resources relative to manufactured goods. Cuddington (1992) considered individual natural resources and measured their values separately, finding that only five of 26 had significant negative trends, four of which were primarily exported by advanced states (p.215-6). Economists now tend to suggest that there exist 'supercycles' in resource prices, and so price values are not consistently downward, but cyclical. Erten (2012) has shown how most resources fall in to "20-70 year complete cycles" (p.1) in their value, potentially querying the Prebisch-Singer hypothesis of a bleak and ever worsening situation for resource exporters. Erten also argues, importantly for Kenya, that the only resource that has almost no support for a decline in terms of trade is oil, which shows a "unique" and "strikingly long-run [upward] trend" (p.10). However, despite this upward trend, the value of oil is by no means steady, and it remains one of the most volatile products on the international market.

Oil's volatility is caused by the low 'elasticity' of both its supply and demand. The world's demand for oil does not rapidly fluctuate, but gradually increases. Meanwhile, adjusting the supply of oil takes time, and production cannot rapidly increase. When a shock to the oil supply occurs, less oil is required to fulfil the same demand, and so the price rapidly increases. When normal supply is resumed, the price of course drops. Financial speculators also greatly affect oil price, and so whilst the value of oil over the years steadily increases, the value at any one time is inherently difficult to predict. Cavalcanti et. al. (2011) have argued that it is this volatility "rather than abundance" (p.1) that causes the resource curse, arguing that this unreliable income makes state planning difficult, with governments unaware of how much capital will be available to them for investment. Again, the case of Nigeria shows us how reliance on oil prices led to government fiscal deficits. The 'oil glut' massively reduced the value of oil, and Nigeria's state planning was suddenly beyond its means. Is there a chance that the volatility of oil prices may have a similar effect upon Kenya?

3.2b – Oil price Volatility and Kenya

The degree to which oil price volatility will affect Kenya's development will likely be determined by the amount of funding the state receives from the resource. This is likely to be high, as governments with large resource reserves almost uniformly receive a significant income from their revenues. Nigeria's government currently receives 80% of its income directly from oil exports (CIA Factbook, 2014b), whilst Saudi Arabia's state receives 90% of its income from oil and gas (IEF, 2014). Having such a high percentage of government income exposed to the volatile fluctuations of the oil price on the international market is of course highly risky, and it is easy to understand Calvacanti's argument that Kenya would find state planning incredibly difficult as their revenue would vary greatly year to year. However, there are a number of ways that Kenya is equipped to resist the detrimental effects of oil's volatility.

Ross (1999) noted that many scholars believed that states that relied on oil, and so were exposed to its fluctuations in the market, would transfer these fluctuations on to the domestic economy. They argued that this made "foreign exchange supplies unreliable and private investment prohibitively risky" (p.301). However, Ross argued that "studies have consistently found that export instability produces unusually *high* levels of private investment, as exporters try to buffer themselves against future price shocks". This leads to the conclusion that "export instability paradoxically produces higher economic growth" (p.304), and so rather than oil volatility harming development prospects in Kenya, it may encourage greater private investment and promote growth. If true, this would coincide with a time where Kenya, irrespective of oil, is likely to see a large increase in private investment.

Kenya's probable reclassification as an MIC in September 2014, can be expected to become "a catalyst for further foreign direct investment" as "telecom groups, banks and food companies traditionally target new middle-income countries as key investment destinations" (FT, 2014). The new classification will not only attract further investment, but also allow Kenya to borrow internationally at much better rates than ever before. Therefore, oil price fluctuations will have less impact upon Kenya's debt repayments, as Kenya will be able to sustain a deficit for longer than before. A short-term drop in the price of oil will have a smaller impact on repayments at a lower rate than the higher rates charged to low-income nations. The reclassification will unfortunately also bring new challenges, as Kenya will lose its preferential trade agreements provided because of its low-income status. The reclassification is "expected to throw the ongoing economic partnership agreement (EPA) negotiations between East Africa and the EU into a tailspin" (Mwakilishi, 2014). Kenya will be required to negotiate trade agreements with the developed world, including the EU, on an equal footing. This would greatly increase the country's current cost of external trade. Therefore, prudent investment in infrastructure and tackling less tangible challenges such as corruption will be essential in order to reduce trading costs, and to ensure trade remains favourable.

3.3 – Chapter Conclusion

The existing theories surrounding the economic challenges of resource abundance suggest that the two most important issues for Kenya to consider are dutch disease and the volatility of oil prices. However, in both cases, there are political solutions that may allow Kenya to avoid the negative effects these challenges can cause. Whilst Kenya is at risk from the indirect de-industrialisation that dutch disease can cause, creating a SWF will allow Kenya to prevent a dramatic increase to the real exchange rate. Depositing a large amount of oil revenue for the future would also safeguard against the state becoming too reliant on the sector for income. Reducing reliance is important, as oil is a particularly volatile and unstable commodity in the international market. Whilst Kenya is unlikely to suffer from a decline in terms of trade, the fluctuation of oil revenue is likely to make state planning challenging. However, Ross (1999) has shown how this may lead to higher private investment and growth, and combined with Kenya's likely new MIC status, the improved interest rates for Kenya's borrowing place the state in a good position to hedge the impacts of price fluctuations. Arezki and Gylfason (2011) have indicated that impacts of price volatility are mitigated more effectively by democracies than autocracies, arguing that democracies generally save resource profits more effectively in order to guard against price shocks, whilst autocracies often embark on ambitious and expensive infrastructure projects (p.3). This highlights a clear political dimension to the curse, and suggests that Kenya's democratic accountability will be important in determining the utility of future policy decisions.

We know the policy measures that a state can take to avoid the economic effects of the resource curse, such as

developing a SWF to offset real exchange rate increases. Yet the 'curse' remains prevalent, and so it seems that the difficulties associated with this paradox may arise from a political inability to implement the required policies. This has led some scholars to argue that the resource curse is fundamentally a political curse, and is caused by the failures of poor policymaking.

CHAPTER 4.0 – The Political Curse

Political explanations behind the failure of policymakers to implement effective policy to resist the resource curse can be broken down into three main branches: cognitive, societal and statist explanations. This chapter argues that the support for cognitive and societal explanations is weak, and argues that statist explanations are of most relevance for the Kenyan case.

4.1 – Cognitive Failure

Cognitive explanations suggest that resource abundance induces myopia amongst policymakers in one of two forms, "myopic sloth" or "myopic exuberance" (Ross, 1999, p.309). Wallich (1960) argued that state revenue from sugar exportation had brought about a 'sugar mentality' among developing nations. This was a form of myopic sloth that led to lax economic planning and poor diversification of the economy. For Wallich, it was careless policies that caused the resource curse, brought about by the comfortable position of holding vast resource reserves. It has been argued that this feeling of assurance has led policymakers to overstretch their abilities. Manzano and Rigobon (2001) showed how developing nations such as Nigeria, "decided to take advantage of high commodity prices in the 70s to use them as implicit collateral" for excessive borrowing, resulting in a "debt overhang when commodity prices fell in the 80s" (p.26). This suggests that cognitive myopia within Nigeria led to Dutch Disease, leaving the state exposed to commodity price volatility. Poor growth then occurred due to the contractionary measures the state had to take in order to repay its debt when oil prices fell.

Whilst cognitive failure offers an easy to understand, and appealingly simple explanation for the failure to implement effective policy, the explanations suffer a number of limitations. Primarily, it denies policymakers the opportunity to be acting rationally. Policymakers are generally well-educated individuals, who are "well-informed about the perils of resource booms", and it is a dangerous assumption to believe that all of these individuals succumb to "wealth-induced stupors" (Ross, 1999, p.310). If this assumption were true, it could be expected that similar myopia could be found within the private sector of resource endowed economies. However, Townsend (1995) has shown that private individuals have higher saving rates in countries where export volatility is high. Private actors can therefore be said to be acting more rationally than policymakers, despite the fact that they possess less information about the economy (p.99). This suggests that something other than myopia affects policymakers, preventing them from acting intelligently or responsibly, and leads to poor decision making. Cognitive explanations are therefore overly simplistic.

4.2 – Societal Constraints

Societal explanations argue that resource exploitation increases the political influence of non-state actors (NSAs) that favour growth-impeding policies, and that it is these NSAs that constrict the policy space policymakers have available to them. Auty (1994) provides the most comprehensive account for this explanation, by examining six NICs, including Brazil, Mexico, and the East-Asian 'tigers' South Korea and Taiwan. Auty shows how all of these states, during the 1950s, adopted the ISI policies Prebisch (1950) had advocated, in order to develop a strong manufacturing base. However, the East-Asian NICs soon leapfrogged Latin America in terms of development and experienced incredible growth rates. Auty argues that South Korea and Taiwan abandoned ISI policies as soon as they became counterproductive, whilst Latin American nations continued to operate them. He argues that this is due to the political power of NSAs with vested interests in growth-impeding policies.

The longer an uncompetitive manufacturing industry has been protected, "the more resistant to change become the entrenched interest groups which benefit from protection and block reform", and Auty argues "in this way a rich natural resource endowment can trigger a set of policy choices which…can transform the resource bonus into a curse" (p.16). The vast resource wealth within Latin America led to a large amount of private actors with a vested interest in the maintenance of ISI policies, as protectionism allowed them to continue to operate inefficiently. This placed huge political pressure on policymakers to maintain ISI policies that harmed economic development. The East-Asian NICs had minimal resource wealth, which ensured less resistance to change, making it far easier for the state to develop a consensus to abandon ISI.

Whilst this may seem a convincing explanation for the failure of policymakers to implement effective policy, the evidence for such an explanation is almost entirely built around the same case studies, such as Taiwan, South Korea and Brazil. This makes it incredibly hard to generalise the theory to more current areas of study, particularly Sub-Saharan Africa. The rise of China has eroded the capacity of developing countries to offer manufacturing as a comparative advantage, and so the number of private actors with these vested interests in modern day Kenya is far smaller than in 1980s Brazil. Moreover, Ross (1999) argues that these societal arguments work best when NSAs have "first claim on any resource rents", and notes that "in almost all developing countries" the state "has first claim on the resource rents" (p.310). Nationalised natural resources are also argued to offer insulation to governments from the political challenges that may arise from privately funded opposition.

Societal explanations lack empirical support and are almost impossible to generalise to modern day Sub-Saharan Africa. Much of the literature focusses on domestic societal challenges, but it may be interesting to consider the impacts of international society. Conditionalities associated with IMF and World Bank loans explicitly constrict policymakers, whilst more subtle constraints arise from the 'soft power' China earns when offering financial help to African nations as part of its 'resource diplomacy'. Kenya signed an oil exploration contract with China in 2006 (All Africa, 2006), and has recently received major finance from China, including $1.6bn to help fund a new railway project (Reuters, 2014). Further research into how this influences resource-based policy decisions may prove relevant for Kenya. Currently however, both cognitive and societal explanations for the resource curse fail to explain effectively its occurrence. The final strand of the political argument considers issues at the heart of the state, to explain how resources may become a curse.

4.3 – Statist Explanations

Having ruled out the potential for cognitive and societal explanations to predict the impact of oil on Kenya, the final strand of political explanations must be considered. Statist explanations argue that differences in states determine the impact resource endowment will have upon development. In this section, three concepts are considered; the rentier-state concept; the influence of corruption; and the strength of institutions. The concepts are first explained, and then considered in terms of their relevance for Kenya.

4.3.1 – The Rentier-State

Rentier-state proponents argue that taxation is the system that links western liberal democratic governments to their citizens. Crucially, taxation allows citizens to feel bound to the state, resulting in a demand for accountability from government, as their income provides the state's revenue. States have to be seen to provide value for money by their citizens, and decisions are scrutinised by the populate. The primary premise of the rentier-state model suggests that when states earn the majority of their revenues from resource rents, there is a reduced need for the state to levy domestic taxes. This results in a state that is less accountable to civil society. Governments focus on collecting resource rents, and so fail to develop the effective institutions and bureaucracy which are required to tax citizens. Unlike traditional 'Weberian' states, a rentier-state is left largely disconnected from its social base, which results in the failure of the state to implement development strategies. Vandermeer (2009) explains that "funds generated from resources support the government regardless of the quality of governance, and in doing so allow states to act independently of the will of the people", with the fundamental issue being that "states do not invest in their citizens, and citizens in return demand little accountability" (p.23).

There is a wealth of statistical evidence to support the idea that states whose incomes are drawn largely from resource rents suffer poor growth. As discussed earlier, an overwhelming majority of resource endowed states collect the majority of their income from resource rents. We also saw how OPEC nations suffered an average 1.3% GNP per capita decrease between 1965-98 (Gylfason, 2001, p.848). Importantly though, the rentier-state model addresses the flaws of cognitive explanations. Cognitive explanations deny policymakers the opportunity to act rationally, and simply say they make poor decisions. The rentier-state model allows these poor decisions for development to be entirely rational. Policymakers are able to act rationally in simply maintaining the status quo rather than implementing expensive and challenging development policies, as they will never face a backlash from a disengaged civil society (Shambayati, 1994, p.308). Rentier-state policymakers' responsibilities lie with maintaining their states income and power position, not to the development of their citizens, therefore these 'poor' decisions are entirely rational and informed.

Kenya of course is yet to collect any resource rents, as she is expected to first export oil in 2016 (Oil Price, 2013). To understand the impact the oil revenue may have, the strength of the Kenyan states' existing taxation system must be assessed. At 30%, Kenya's upper level income tax band is the joint tenth highest in Africa, and the state operates a progressive tax system that provides only a small percentage of citizens complete tax relief, whilst the entire system provides 90% of the state's revenue (Deloitte, 2014, p.3). Kenya is currently far from a rentier-state model, such as Qatar where there exists no personal income tax. Despite the temptation to simply rely on resource rents, Kenya must maintain a focus on its existing taxation system if it is to avoid the curse. Moore (2001) has shown that states that abandon their social tax base become exposed to 'political pathologies' that threaten development, including coups and an ineffective civil service that reduces the information a state requires to implement development policy (p.404-5). It is probably safe to assume that Kenyan's dislike taxes. However, to lose the effective taxation system Kenya has in place would be to place the country at risk of falling foul to the 'political pathologies' that result in poor policy decisions, and Kenyans would be well advised to maintain their source of accountability.

4.3.2 – Corruption

Corruption is argued by many scholars to be an important factor in determining the outcomes of resource wealth, as high resource endowment is "strongly associated with a worse corruption perceptions index…which in turn is associated with lower growth" (Van Der Ploeg, 2010, p.19). The rentier-state model explains how corruption occurs due to the two fundamental interests of policymakers: maintaining power and profiting from resource rents. States may achieve these aims by sourcing rent from "clientele networks", effectively "bringing the wealthy and powerful in to the fold" (Vandermeer, 2009, p.24). These networks are able to purchase political influence, whilst the state utilises the income to pay off political challengers. Fjelde (2009) argues that this income allows rentier-states to "buy off" anyone who may "challenge government authority" (p.203). Corruption becomes the state's solution for avoiding the 'political pathologies' of relying on resource rents for revenue, and secures its power position. Meanwhile, policymakers are able to personally profit from making poor decisions in terms of development, with only a limited chance of a disengaged populate showing concern.

Deninger and Mpuga (2004) have shown how "high levels of corruption…bias public spending in undesirable directions and reduce the quality with which such services are provided" (p.171). If we know that corruption produces poor policy decisions, and that corruption increases with rentierism and resource endowment, then corruption is likely to become a major challenge for Kenya. Kenya is already ranked among the world's most corrupt countries, with the 2013 Corruption Perceptions Index (CPI) ranking the country as the 39th most corrupt of 175 countries (CPI, 2013). In 2010, the Kenyan government revealed that almost a third of its national budget, approximately £2.5bn, may have been lost to corruption (BBC, 2010). Transparency International (2011) found that Kenyans were expected or demanded to provide bribes in almost 30% of their dealings with "service delivery institutions", notably the police (p.8). Kenya clearly already suffers a chronic problem of corruption, and without greater transparency, oil revenues and rentierism are likely to aggravate this problem further. Corruption results in poor policy making, and an increase will certainly hinder Kenya's abilities to address the economic challenges their resource endowment will cause to arise.

4.3.3 – Institutional Strength

Mehlum et. al. (2002) provide a very convincing empirical study that highlights the importance of institutional quality in determining the effects of resource wealth. They identify the very different impact resource abundance has had in states where institutions are "grabber friendly" as opposed to "producer friendly" (p.1). Essentially, the institutional approach examines the relationship between rent-seeking and production within an economy. Rent-seeking is an unproductive force, as the more 'rent' that is removed from the resource sector, the lower the economic returns are to that sector. If rent-seeking reaches too high a level, the low returns discourage entrepreneurism and so limit the overall productivity of the economy, and inhibit growth. The more 'grabber' friendly a country's institutions are, the more beneficial the unproductive rent-seeking activities are. For example, a strong rule of law reduces the likelihood of corruption. This reduces the impact of rent-seeking on returns for producers, and so a strong rule of law can be considered a 'producer friendly' aspect of a state.

Mehlum et. al. find a strong, significant relationship between the quality of institutions and the effect on growth, concluding that "resource abundance is harmful to growth only when the institutions are grabber friendly" (p.16). They note that Botswana, Africa's only success story, had "the best African score on the Groningen Corruption Perception Index" (p.2). They also note that four of the five resource endowed nations, that the World Bank (1994) identified as being in the top 15 countries with the highest incomes, "have an institutional quality" above their identified threshold where the resource curse would not occur (p.17). We know that Kenya already suffers from corruption, but we must consider the overall quality of Kenya's institutions in determining the impact they may have. The Economic Freedom of the World index (EFW) offers perhaps the most comprehensive analysis of the quality of a country's institutions.

The EFW considers factors such as the security of property rights, the legal structure and levels of corruption to produce an overall score that indicates institutional quality. The 2011 report places Kenya as the 6th highest Sub-Saharan African country on the list, and 87th of the 152 countries measured. The results here seem fairly positive: the successful Botswana placed 52nd with a score not too far from Kenya's. Perhaps most significant is the score of Angola, a classic example of the resource curse, where oil has crippled development, ranking 147th of the 152 (EFW, 2011, p.8). A closer analysis indicates that it is Kenya's "legal system and property rights", one of the five main factors of analysis, that holds Kenya's score back (p.12), with the "integrity of the legal system" ranking amongst some of the lowest scores in the index (p.99). If this factor is removed, Kenya's overall score leaps from 6.81 to 7.33, placing Kenya above Botswana and as second highest African nation.

Kenya's lack of legal integrity is clearly holding the country back. The rest of the EFW's contributing factors are able to pull Kenya's score up to the sixth highest in Africa, but an improved legal system would see it among the best on the continent. Mehlum et. al. (2002) have shown evidence that indicates institutional quality determines the impact rent-seeking has on development, and so the result must be a two-fold focus for Kenya. First, it must address the 'integrity' of its legal system, which is clearly shockingly low. It must also address the chronic problem of corruption within the country. Of course, it is highly likely the two will go hand in hand.

4.4 – Chapter Conclusion

The economic challenges brought about by resource wealth clearly have identifiable policy solutions, and so the challenge of the resource curse lies with the political difficulty of their implementation. This chapter considered the current literature that attempts to explain the widespread failure of policymakers to adopt effective policy. Cognitive explanations of 'myopia', whilst appealingly simple, are unfortunately overly so as they accept policymakers to be acting irrationally within government. Evidence shows us that the private sector does not show any signs of similar myopia, and so clearly something else must affect public sector policymakers.

Societal explanations sought to respond to this evidence by arguing that a powerful constraint originates from the increased political power of NSAs that benefit from growth-impeding policies. Businesses and employees in the ISI protected manufacturing industries of Latin America are argued to have become powerful, entrenched and resistant towards growth policies. However, the rise of China has significantly eroded the ability of developing nations to offer manufacturing as a comparative advantage, and the number of people favouring these policies is therefore far lower than it used to be. Existing societal explanations are consequently inappropriate in their application to modern day

Sub-Saharan Africa, and the theories would gain utility by considering the more modern day pressures of international society, such as the 'soft power' China has gained through their 'resource diplomacy'.

Statist explanations offer by far the most compelling account for the political side of the resource curse. The 'rentier-state' concept suggests that state rent-seeking erodes the accountability that a state has to its citizens, and so removes the incentive for policymakers to pursue development strategies. This transforms a state's priorities into goals of power consolidation and personal gains. This is associated with corruption, which is shown to have a positive relationship with resource wealth, and to negatively influence growth. The work of Mehlum et. al. (2002) reveals the significant impact that the quality of institutions within a country may have upon the consequences of resource abundance. Consequently, statist explanations, backed by a wealth of empirical evidence, provide multiple considerations for the case of Kenya.

Firstly, Kenya is far from a rentier-state today. It has a strong, effective taxation base, generating significant accountability to its populate. However, the government will inevitably engage in rent-seeking once the oil sector is booming. The maintenance of Kenya's strong taxation base is essential if it is to ensure the incentive for the state to pursue development strategies will remain. Kenya is unfortunately riddled with corruption, and as resource wealth seems to have a positive relationship with levels of corruption, the country faces a worrying situation that may be set to deteriorate further. Corruption reduces the quality of policymaking, and alongside a legal system that lacks integrity, presents a major institutional challenge for the state.

If Kenya is able to maintain its effective taxation, improve transparency to reduce corruption, and address the problems within its legal system, it will be well placed to implement effective policies that will turn their oil into a blessing. However, there is no doubt that Kenya's abundance of oil will present a challenge to all of these tasks, and Kenya would do well to consider the case of Venezuela. The country ranked 14th on the EFW in 1980, but by 2011, oil had driven the country down to 152nd, last place (EFW, 2011, p.174). Monaldi (2006) has shown how the Venezuelan state followed an all too familiar path of over-ambitious investment, which collapsed when oil prices fell. The institutional and economic reforms that were then implemented resulted in policies becoming "more volatile and shortsighted" (p.2). This reveals the potential of short-sighted policy to erode existing institutional strength, and indicates that a loss of this strength may lead down a path of further ill-advised policy decisions. Kenya remains better placed than many to transform their oil into a blessing for the country, and the creation of the Kenyan SWF perhaps indicates that the state is on the right path in terms of effective policymaking. However, any economic and political progress could easily derail if Kenya's resource wealth were to trigger a civil conflict.

CHAPTER 5.0 – The Conflict Curse

Collier and Hoeffler (2000) controversially stated that "the extent of primary commodity exports is the largest single influence on the risk of conflict" (p. 26). Given the likelihood that the levels of Kenya's commodity exports is set to explode, alongside Kenya's troubled and violent recent history, the literature concerning the effects of resource wealth upon conflict are important. Most of this literature can be divided into two main categories: 'greed' and 'grievance' theories.

5.1a – 'Greed' Hypothesis

The 'greed' hypothesis was first presented by Collier and Hoeffler (1998), and suggested that primary commodities can provide the incentive for 'would be' rebels to rise up against the state (p.563). Crudely, rebels become aware of the wealth or power that they may gain from the control of natural resources, and so decide to resist the state in order to pursue this goal. The potential income is large enough to leave rebels willing to risk personal security, in order to gain private wealth. Once rebels secure access to resources, they secure funding for future operations, and so movements will often grow. However, even without resources, rebels can secure funding through 'future sales', by

promising to secure them for businesses or individuals. They may also gain support from diasporas that will fund these rebels as they desire greater power (p.568). Clearly, grievances are not irrelevant for the 'greed' hypothesis, but the determining variable is the greed of intentions.

There are multiple examples to support this 'greed' hypothesis that are familiar. Collier and Hoeffler (2005) cite "diamonds in West Africa", opium in Afghanistan and "cocaine in Columbia" as examples of rebel movements premised on 'greedy' intentions. However, oil is found to promote much more drastic effects. If oil is present, a rebellion "is almost certain to be secessionist" (p.630). This is particularly true within the African continent, as examples such as MEND in Nigeria, the Cabinda conflict in Angola, and the SPLA in South Sudan all show. The discovery of oil can leave 'would-be' rebels sat on top of a gold mine. As discussed in the previous chapters of this paper, oil can erode the quality of a country's institutions, leaving rebellion and even secessionism both feasible and rewarding.

5.1b -'Grievance' Hypothesis

The 'grievance' hypothesis suggests that motivation for rebellion lies in addressing grievances, rather than a desire to increase personal wealth. Humphreys (2005) has argued that countries with large oil wealth are more prone to civil conflict, because of the grievances oil can cause to arise. Citizens, aware that their country possesses a valuable commodity, expect improvements to their living conditions. However, for multiple reasons, as discussed throughout this paper, improvement or development rarely occurs. Therefore, groups often feel marginalised by the state, and so the "opportunity cost" of rebellion is reduced as "they have more to gain by going to war than they do by remaining at peace" (Vandermeer, 2009, p.37). Government institutions and bureaucracy may erode as a state becomes a 'rentier-state', and Fearon and Laitin (2003) argue that a weak state, military and police force favours "the technology of insurgency" (p.4). Therefore, institutional erosion makes resistance both feasible and probable.

Importantly, Vandermeer (2009) notes that oil wealth has the capacity to "increase existing divisions" (p.37), and so exacerbate tensions that may already exist within a society. If oil wealth is not seen to be distributed equally throughout a society, or is perceived to favour a particular group, grievances can reach a tipping point, and trigger rebellion. The SPLA in Sudan argued that "the Khartoum regime did not equitably distribute oil wealth, especially since the oil is predominantly located in the southern region" (p.37). This shows that it was not just greed at play in the SPLA movement, but a grievance due to the perceived inequality of distribution. Clearly, all societies have grievances, and so it is likely that it is the weakening of the state and its institutions that may occur after the discovery of oil, that alters the cost-benefit analysis of 'would-be' rebels, and results in conflict.

5.2a – Probability of Conflict in Kenya

Unfortunately for Kenya, of all natural resources, oil is consistently found to have the most distinctive relationship with civil conflict. Collier (2007) has noted a number of statistical indicators that can be considered when attempting to understand the likelihood of civil conflict. Firstly, the amount of primary commodity exports as a percentage of GDP is a useful measure, as at 10% the risk of civil conflict is 11%, whilst at 25% the risk is 29%. Collier concludes that a higher share of commodity exports "substantially increases the risk of conflict" (p.324). These risks are even higher if the primary commodity being exported is oil. Kenya's existing exports, of which most are primary commodities, currently amount to $6.58bn, approximately 14.5% of GDP (CIA World Factbook, 2014). However, this number will likely soar as Kenya begins to exploit its potential 20bn barrels of oil. We can look to Nigeria as an example of how Kenya's primary exports as percentage of GDP structure may change. Nigeria's exports, primarily oil, amount to $93.55bn, or 32% of their GDP. Nigeria has of course been blighted by the secessionist MEND movement, that are known for "kidnapping oil workers, attacking oil fields" and "blowing up pipelines" (BBC, 2010). Collier's model certainly suggests that the risk of conflict will increase in Kenya in the coming years.

Collier (2007) also notes the utility of GDP per capita as a useful indicator, stating that "at high levels of per capita income, the risk of war is negligible, with or without resources". As discussed, Kenya is likely to soon be upgraded to MIC status, thanks to an improvement in its per capita wealth. However, Kenya remains far from the GDP per capita incomes of Australia and Norway, "which are highly dependent upon natural resource exports, but are also rich" and

therefore "do not face any significant risk from their natural resource endowments" (p.324). We must be wary of using per capita income to predict outcomes though, as this figure can be skewed by a small percentage of the population holding the majority of the wealth, and so hide the general level of income. Nevertheless, Kenya currently ranks 198th out of 229 countries for per capita income (CIA World Factbook, 2014), and so the country's low per capita income does not seemingly indicate any potential to mitigate the risk of conflict.

Statistically at least, Kenya is likely to be at risk of conflict and rebellion as oil exports increase. Whilst oil exports may increase the per capita income, and so lower the risk in this part of Collier's model, they will increase the share of commodity exports as a percentage of GDP, and leave the overall statistical risk high. Collier stresses the dangers of oil exports in particular, and so Kenya must consider the challenges of both the 'greed' and 'grievance' hypotheses in preventing the challenges of civil conflict.

5.2b – Addressing the Probability of Conflict in Kenya

The key to addressing potential 'greed' is simple enough: Kenya must maintain strong enough institutions in order to alter the cost-benefit analyses of 'would-be' rebels in favour of inaction. The fear of reprisal and danger must overwhelm the potential to make financial gain. We know that Kenya's legal system is the weak link in the country's otherwise relatively strong institutional structure. However, we have also discussed how oil has the potential to erode institutional quality. As discussed earlier, preventing excessive state rentierism and maintaing an effective tax base will allow Kenya to maintain strong institutions, and should help in preventing civil conflicts triggered by greed. A larger challenge for Kenya will be in addressing potential grievances to prevent conflict.

As we have noted the potential of oil to exacerbate existing grievances within a country, we must consider the existing tensions within Kenya to understand how these may be affected. The majority of Kenya's tensions originate from the fact that it is a very ethnically diverse country, with over 70 distinct ethnic groups. Whilst no group forms an overall majority, the 'Kikuyu' make up 20% of the population (Ayyaantuu News, 2013). Minor skirmishes are fairly common in Kenya, with rival groups often confronting each other over access to land and water (Relief Web, 2014). However, the 2007-2008 'Kenyan Crisis' highlighted the ethnic tensions that remain simmering within the country. The Kikuyu have "dominated business and politics in Kenya since independence in 1963" (NYT, 2008). However, the 2007 presidential election showed the then president, and Kikuyu, Mwai Kibaki to be polling far behind opponent Raila Odinga, a 'Luo'. To much surprise, Kibaki was announced as the winner of the election, leading Odinga to denounce the election as "rigged".

EU observers agreed the election was "seriously flawed" after their "officials had been turned away from the central vote-counting room in Nairobi" (Washington Post, 2008). Kenyans were outraged, and multiple ethnic groups turned their fury on to the Kikuyu. Over 1,000 were brutally murdered in the ensuing uprising, with over 600,000 being displaced (CBS News, 2008). The incumbent president Uhuru Kenyatta remains on trial at the ICC, accused of orchestrating the ethnic cleansing of pro-Odinga groups during the post-election violence, where mobs "hacked or stabbed their ethnic enemies to death" or "burnt them alive" (Telegraph, 2013). This relatively recent instability reveals that ethnic tensions in Kenya possess the true potential to develop into bloody conflicts, and that anti-Kikuyu sentiment remains fresh and widespread throughout Kenya as other ethnic groups continue to resent their economic and political dominance.

This becomes particularly important for Kenya when considering that the oil has been discovered in the Great Rift Valley region, an area where "the anti-Kikuyu grudge goes back to independence". Upon independence, the British redistributed land to the Kikuyu rather than other ethnic groups like the Masai who had lived there for hundreds of years. Kikuyu in the region, whilst owning much of the land, "are vastly outnumbered" (NYT, 2008). In Nigeria, the MEND movement fights for secession, arguing that oil revenues have been of no benefit to the local people of the Niger Delta. The case acts as a warning for Kenya: if oil revenues are perceived to favour the Kikuyu, and benefits are not fairly distributed, old grievances will certainly arise. If Kenyans feel they have much to gain from rebellion, and are at little risk from a state with limited capacity, conflict as seen in Nigeria and Sudan may be inevitable. Kenya's oil is also highly likely be a target for Al-Shabaab, the militant Islamist organisation behind the 2013 Nairobi shopping mall attack, who have vowed to strike Kenya again, and have previously targeted the oil infrastructure of both

Somalia and Uganda (Kenyan Post, 2014).

5.3 – Chapter Conclusion

Resource endowment is undoubtedly associated with an increased risk of civil conflict. The two most common explanations of how these conflicts begin lie with 'greed' and 'grievance' explanations. Greed hypotheses argue that personal gains from resource ownership acts as the incentive for rebellion, whilst grievance hypotheses suggest that resources become a means to address the grievances that groups may feel. Collier's (2007) work suggests that the statistical likelihood of conflict in Kenya is high, and is likely to increase as oil exports gather momentum. How might Kenya address the risks associated with triggering both greed and grievance based conflicts?

Preventing greed based conflicts will likely be the easier of the two for Kenya. As the greed hypothesis suggests that 'would-be' rebels undertake a cost-benefit analysis in determining what action to take, the government must attempt to make inaction the most viable option. This can be achieved through institutional power. A strong military and police force will prevent rebellion becoming a feasible option. However, this remains a political challenge as the government must avoid excessive rentierism, which leads to a weakening of state institutions. Oil has also been shown to exacerbate existing tensions within a country, and Kenya has historically been home to a massive amount of simmering ethnic tension. The Kikuyu, as majority land owners in the Great Rift Valley, as well as dominating Kenya's economy, stand to benefit the most from Kenya's oil abundance. If quality of life does not improve for the rest of Kenya, and they witness the Kikuyu dominate the oil sector, anti-Kikuyu sentiment will likely be inflamed. This sentiment led to accusations of ethnic cleansing after the 2007 election, and similar grievances have fuelled a violent secessionist movement in the Niger Delta. The very real potential for hostility means that the Kenyan government must seek development and transparency in order to prevent another bloody ethnic conflict, which will be absolutely crucial in ensuring Kenya's continued development.

CHAPTER 6.0 – Conclusion

Throughout this paper, the existing literature on the paradoxical 'resource curse' has been considered and critically analysed in order to present a summary of the dangers facing Kenya as it moves towards the exploitation of its newly found oil reserves. It has also attempted to suggest ways in which Kenya could avoid becoming another cursed nation. Kenya will face many economic difficulties due to its oil endowment, of which 'Dutch Disease' and the volatility of oil prices will likely be the most challenging. However, Kenya is well placed to resist Dutch Disease, as its large labour surplus leaves it unlikely to suffer from direct-deindustrialisation. The creation of a Kenyan SWF should also help avoid the indirect-deindustrialisation that may be caused by an increase in the real exchange rate. Kenya's upgrade to MIC status will increase investment, and improve borrowing rates, which should allow the country to also guard against oil price volatility. These policy solutions to the economic challenges of resource wealth reveal that there is a clear political dimension to the curse.

There are multiple explanations behind why policymakers consistently fail to implement effective development policy in countries of resource wealth. Cognitive explanations of myopia are too simplistic to offer a true explanation as they assume irrational behaviour, whilst societal explanations lack modern day applicability. China now dominates the world's manufacturing sector and so the theories cannot explain the curse's prevalence in Sub-Saharan Africa. It is the rentier-state model that offers the strongest explanation, and holds most relevance for the case of Kenya. Excessive state rentierism erodes the accountability a state has to its citizens, and so removes the incentive for the implementation of development policy. Kenya must maintain its strong taxation system if it is to maintain this incentive. Rentierism also encourages corruption, a problem Kenya is already clearly riddled with. Corruption discourages development, and so Kenya must seek to improve transparency if it is to benefit from its oil abundance. Finally, weak institutions are shown to determine the impact oil may have. Kenya's legal system is its weakest institution, and resources have been seen to lead to institutional deterioration. The Kenyan state must maintain its tax

base and avoid excessive rentierism, whilst reducing corruption and strengthening its institutions in order to guard against poor policymaking.

Failure in achieving these political challenges, will not only leave Kenya exposed to the economic risks of dutch disease and oil price volatility, but potentially increase the risk of civil conflict, which would be disastrous for the country. The value of Kenya's oil may lead to an increased risk of rebels attempting to make personal gains from the resource, and so greed must be mitigated by maintaining institutional strength, which will reduce the incentive for these 'would-be' rebels. However, of vital importance for Kenya is the fact that oil also has the potential to aggravate existing tensions within the country. The Kikuyu are widely considered to dominate Kenya's political and economic arenas, and despite being a minority in the Rift Valley area, they own much of the land, making the financial gains of oil highly likely to benefit the group. If the benefits are not fairly distributed throughout Kenya's ethnic groups, the already high potential for conflict will grow further. Weak institutions and poor development policies could trigger a bloody ethnic conflict that would undoubtedly derail Kenya's development path.

Kenya is in a stronger position than many African nations to be able to benefit from their newly discovered oil reserves. With a solid bureaucracy and taxation base, the state has a strong connection with its citizens. It has a relatively effective set of institutions that are well placed to handle the stresses oil will bring. The announced SWF reveals Kenya is aware of the dangers it faces, and will attempt to address them. However, it must avoid a shift to excessive rentierism. This has the potential to increase already widespread corruption, which often results in poor policy decisions. It may also erode institutional quality, not only negatively influencing policy, but increasing the risk of civil conflict within the country. Ethnic tensions have close ties to the region in which oil has been discovered, and there is a real danger of these developing into serious conflict. Kenya needs to improve transparency and address corruption, whilst strengthening its institutional infrastructure and ensuring fair distribution of its oil profits if it is to avoid joining the long list of states 'cursed' by oil.

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