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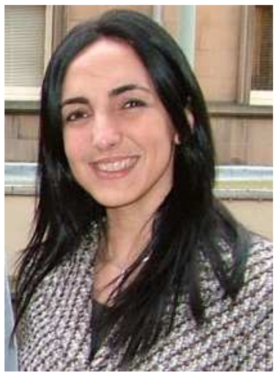
Turning the resource curse into a blessing

How to further social and economic development in resource-rich countries

The fact that many developing countries rich in mineral resources have not been able to sustainably harness the resource revenues for their social and economic development has been called the 'resource curse'. In this issue of the Foreign Voices, Argentinean lawyer Dr Ana Elizabeth Bastida of the University of Dundee and British economist Dr Paul Segal share their views on how to overcome the resource curse and further development in resource-rich developing countries. Both authors agree that hopes for a "trickle down"-effect of resource revenues have been disappointed. However, they propose different approaches: While Bastida aims at state capacity building and improved governance, Segal's proposal is the direct distribution of resource revenues on an equal per capita basis to all adult citizens of the respective country. Bastida and Segal were speakers at the concluding conference of the project series "Global Resource Management".



Dr Ana Elizabeth Bastida

Director of the International Mining Programme,
Centre for Energy, Petroleum and Mineral Law and Policy
(CEPMLP), University of Dundee, Scotland, UK

"The era of competition for resources raises crucial governance challenges."

The dramatic rise of mineral prices, driven by demand in China, India and other countries undergoing industrialisation has been the defining event in the mining sector in very recent years. This follows a period of historically low prices. Rising concerns over security of supply, coupled with concomitant tremendous profitability, has triggered enormous exploration interest from a large range of companies of diverse origins. The era of international competition for investment seems to be paving the way for a new era characterised by competition for resources.

This presents remarkable investment and development opportunities for mineral resource-rich countries. However, it also raises crucial governance challenges. Mining can have a key role to play in creating wealth that will act as a catalyst for development *if* proper governance structures and institutions are in place to manage development.

The neglected dimension of mining: development

Law and policy models in the mining sector in developing countries during the 1990s – as disseminated by international development institutions – focused on a regulatory role for the state, instrumental in creating an enabling and competitive environment for investment, its share being limited to the fiscal take. In other words, once the government dealt with the key aspects of good economic performance (liberalised trade, macroeconomic stability and getting prices right), private markets would allocate resources efficiently and generate growth. It was assumed that benefits would "trickle down" to the poorest in society. The legal system had a role in creating a climate of stability and predictability in order to provide the conditions for business activity and increased foreign investment in the economy. The law was to buttress the institutions of well-functioning markets: guarantees for property rights, enables contract enforcement, minimises regulation and protects against arbitrary government power.

As investment has started to materialise, driven by very attractive legal and fiscal regimes, disillusionment with the environmental and social impacts of the activity, as well as its often poor contribution to local economic development have become commonplace. In many cases, the very same basis of competitive fiscal terms for investment have been challenged. An increasing number of governments are requiring the renegotiation of existing arrangements, most notably with regard to fiscal terms and State equity participation, or the establishment of royalties or more stringent fiscal terms for investment. An exclusive focus on competitiveness seems not only to have neglected the potential developmental dimension of mining, but also precluded regimes from attaining the very same stability that investment requires to operate over time.

Much is being said on the need of concerted action between different actors involved in, and affected by, mining projects; on the role of international initiatives in promoting investment standards; and on the adoption of corporate responsibility policies by international companies, to ensure the contribution of mining to sustainable development. Furthermore, the conclusions of ongoing studies by the International Council on Mining and Metals (ICMM), the United Nations Conference on Trade and Development (UNCTAD) and the World Bank on strategies adopted by countries that have enhanced the contribution of the mining sector to sustainable development (such as Chile and Botswana) have started to emerge. They show the importance of the overall quality of governance as a fundamental factor in determining success. This illuminates the flaws in assumptions and analysis behind policy recommendations in previous development models, and emphasises the crucial point of the need of building state capacity.

While the process of reform during the 1990s, as supported by international organisations, focused on the interactions between the needs of a global industry and national economies, the reform agenda now is far broader and more complex. This is interwoven with other legal regimes and voluntary initiatives, embedded in broader governance structures, and motivated by local contexts and the dire pressures on governments – in partnership with companies, international organisations and other actors – to ensure the contribution of mining to sustainable development.

Meeting sustainable development objectives

Governments and international organisations will need to fully embrace the challenges of that broader agenda. Consensus seems to be emerging at a conceptual level on the need to articulate law and policy in the sector in ways that meet sustainable development objectives; to strengthen the overall quality of governance – on which the sector is embedded – and to build state capacity. However, the precise definitions, scope and methods of these core concepts are much contested, context-specific, and certainly allow for great divergence of policy outcomes.

If existing models provide a useful starting point, it is clear there is a need to build on them with a view to complementing, perfecting and testing the workings of their institutions in the context of sustainable development. From this statement it follows that governments' and international organisations' efforts at reform in the sector should go *beyond* the existing set of law and policy recommendations. Certainly, the approach must be based on legal, regulatory, contractual and fiscal arrangements that encourage investment. But critically, the approach must also ensure the maximum contribution to national, regional and local economic development, in ways that balance the rights and conflicting interests of all the actors involved in and affected by development through transparent and inclusive processes.

Mechanisms and institutions for monitoring and enforcement are as important as legal and contractual terms and processes. Enforcement is often hindered in many developing countries by lack of financial and technical resources, especially in dealing with mega-projects in relation to which there is frequently little or no experience. Equally, effective and transparent mechanisms and institutions for revenue management are as important as equitable government rent and its allocation and distribution to lower levels of government.

The need to focus on capacity development

Beyond the specific contents of law and policy, little attention has been devoted to the importance of the endogenous mechanisms and processes by which law and policy are designed, discussed, adopted and implemented. Additionally, it is important to note the extent to which these mechanisms and processes are inclusive of different social and political interest groups. In other words, there must be greater exploration of the appropriate political mechanisms and legal processes that legitimise sector specific legislative reforms through domestic policy processes – in contrast to the mere adoption of legal transplants, which featured reform in the 1990s. This lends legitimacy and thus corroborates policy stability and coherence. Likewise, weaknesses encountered in models that are transplanted should foster reflection on the need to focus on capacity development for good law and policy-making.

Beyond the law, there is clearly a need to further expand knowledge of policies and institutions adopted by countries that have enhanced the contribution of the mining sector to sustainable development. This requires comprehensive analysis that transcends the mining sector and examines the structure and functioning of overall governance structures, bringing in the analytical tools of broader disciplines.

Increased bargaining power of resource-rich countries, triggered by the boom in the industry, is expanding the political space for more assertive claims. Looking back in history, it seems that previous development models implemented in the sector assumed both state capacity and automatic "trickle down" effect to advance broad-based socio-economic development. However, the fundamental question of building state capacity to manage the sector and beyond that, to contribute to the overall quality of governance and institutions, would appear to have been underhighlighted. The lesson to take is to go beyond specific sector reforms and to consider the sector's role as a potential contributor (rather than a hindrance) to supporting state capacity building (as has been pointed out by my CEPMLP colleague Evelyn Dietsche).

Ultimately, the development of an authentic and more mature vision for mining sector governance, that stands the test of time and mineral prices' cycles, requires learning from past errors and experiences and a reassessment of mutual goals and appropriate strategies and processes.

Dr Paul Segal

Research Fellow,
Oxford Institute for Energy Studies (OIES)
and New College, Oxford

"The net effect of the people's share proposal would be a large reduction in poverty and inequality."

Resource wealth has been a paradoxical phenomenon for many developing countries. Rather than bring prosperity, the discovery of valuable natural resources has often led to economic and political turmoil in diverse countries across the world. These countries typically suffer from low growth, weak institutions, and a lack of democracy, and their failure to develop has left high levels of avoidable poverty. Oil, presciently described in 1975 as "the devil's excrement" by the Venezuelan co-founder of OPEC, Juan Pablo Pérez Alfonso, has been the primary culprit. Today, with oil and other commodity prices rising to record levels, it is apposite to discuss a proposal that could drastically reduce poverty in resource-rich countries, at the same time as neutralising some of the routes through which resources can become a curse.

Oil revenues as an unconditional basic income for the people

In 1978, in the context of the discovery of British North Sea oil, the Financial Times journalists Samuel Brittan and Barry Riley commented: "The simplest and also the wisest answer to the question 'What should we do with the state's oil revenues?' is 'Give them to the people'." In this article I explore the potential benefits of a version of this idea that I call the *people's share proposal*: instead of resource revenues accruing to governments, whether from a national oil company or from taxes and royalties on private companies, they would pass directly to all adult citizens on an equal per capita basis, in the form of an unconditional basic income. A full discussion of this proposal is most pressing for developing countries suffering from the resource curse.

The first potential benefit is the direct impact on poverty and the distribution of income. An important part of the resource curse is the economic problem known as the Dutch Disease: a natural resource export sector renders tradable goods other than the natural resource, such as manufacturing, uncompetitive. Since development and growth are typically driven by manufacturing, this makes development over time very difficult. But it also has short term costs in terms of unemployment and the distribution of income. Why? One of the core characteristics of natural resource sectors is that they employ very few people. This implies that the direct benefits of the resource go to whoever owns it, which in most cases will be the government. Unlike in manufacturing, very little of the resource revenues go to workers. There is no automatic economic mechanism, no 'trickle down effect', for distributing the income from the resource throughout the population. Most citizens enjoy too little of the benefits of resource wealth, and suffer too much of the burden.

All poverty in countries like Mexico or Nigeria could be eliminated overnight

In principle, governments could spend the resource revenues in such a way as to spread their benefits broadly, or to target poverty reduction. But in many cases it appears that government efforts to reduce poverty are less successful than the current proposal would be. Consider the example of Mexico, a middle-income country. The national oil company Pemex had an operating surplus of US$58 billion in 2006 from selling 3.3 million barrels of oil a day, of which about US$54 billion went to the government in taxes. There are about 65 million adults in Mexico (out of a population of 105 million); dividing US$54 billion by 65 million would yield over US$800 of annual income to every adult under the people's share proposal. Taking account of price differences (using purchasing power parity, or PPP, exchange rates), this amounts to about $1200 in terms of real purchasing power. The government would have to recoup the loss in taxes, of course. US$54 billion is about 7 percent of GDP. With consumption comprising about 70 percent of GDP in Mexico, a rise in consumption tax of 10 percentage points would be one way to make up for the lost government revenue.

Now consider the impact on poverty. According to the World Bank, 26% of the Mexican population live below $2 a day (in PPP$). All of this poverty would be eliminated overnight. The rise in consumption tax required to restore government revenues would not undo this effect, reducing the $1200 to perhaps $1080 in real terms. Even though consumption taxes are relatively regressive, the whole package would be highly progressive for the distribution of income.

Nigeria is an even more extreme example. Nigeria produced 2.2 million barrels of oil per day in 2006, and has an adult population of about 70 million (out of a total of 130 million individuals). If Nigeria were to get the same $45 of profit per barrel that Mexico achieved in 2006, this would come to $520 per adult per year. In terms of real purchasing power, this would be more like $1,300. According to the World Bank, 70 percent of the population live below $1 a day. Like the higher poverty line in Mexico, all of this poverty would be eliminated.

"No representation without taxation"

The second benefit of the proposal (as has been pointed out by the IMF economist Arvind Subramanian) is that it can help to counteract the political and institutional roots of the resource curse. First, resource-rich countries tend to have poorly-developed government institutions. Governments may be rich, but they often have weak control over the economy and society. The reason is that the ease of extracting revenues from the natural resource implies that governments do not need to do the hard work of creating bureaucracies and systems of conflict resolution that are required in order to collect taxes from the non-resource economy. Second, political scientists have argued that this lack of taxation also helps to sustain non-democratic governments. The catch phrase for this argument is "No representation without taxation" – if governments do not tax their citizens, then the citizens do not demand democracy and government accountability. Without strong institutions and healthy accountability, governments have little incentive to provide the public goods required for development. Giving revenues directly to individuals could improve government performance in both respects. By requiring governments to tax households and businesses in the economy it would force them to develop effective institutions, and to account for their use of taxes to the population.

A further possible benefit regards conflict in resource-rich countries. Natural resources often fuel conflict by providing funding for civil wars. They also provide a strong incentive for violent coups: a coup leader faces the promise of great wealth as soon as he or she takes control of the government. The prospect of this wealth then makes it easier to fund a coup in the first place. Under the people's share proposal, taking over the government would not automatically provide a coup leader with revenues. He could of course confiscate the revenues, but a population used to receiving a resource income might offer more resistance than a population used to seeing revenues absorbed into government budgets.

Furthering transparency and hindering corruption

Would the scheme be open to corruption? If corrupt individuals can skim off revenues now, why would they not do the same under the present proposal? Here a highly successful experiment from Uganda gives reason for optimism. The Ugandan government found that only 20% of the money that was being sent to primary schools other than for teachers' salaries was actually reaching the schools. They came up with a novel plan: whenever the government released money for schools it informed the local media and sent a poster to each school stating what it should be receiving. Three years on they found that 90% of the money was getting through. The lesson is that when people know what they are due, it is much harder for corrupt individuals to keep it from them. It is this idea that has fostered the current wave of transparency initiatives, which hold great promise. The present proposal fits this trend well: the people's share would be public knowledge, and individuals would immediately know if they were being short-changed.

The net effect of the proposal would be a large reduction in poverty and inequality. But would such a redistribution be politically feasible? There is reason to believe that the proposal could be popular within resource-rich countries. Major oil-producing countries tend to be firmly nationalistic towards their oil. In many cases these countries have won hard-fought battles with international oil companies to reclaim ownership of their sub-soil resources, and in the process citizens have developed strong feelings that the oil belongs to them. In Latin America the recent surges in resource nationalism have been associated with opposition to perceived exploitation, not only by foreigners, but also by domestic elites. Some fear that this is leading to populism and a retreat from democratic accountability. The people's share proposal is both poverty-reducing and profoundly democratic, and may be a more constructive outlet for such sentiments.

Imprint

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Development and Peace Foundation
(Stiftung Entwicklung und Frieden - SEF)
Gotenstraße 152
D-53175 Bonn

Phone: +49 (228) 95925-0
Fax: +49 (228) 95925-99
Email: sef@sef-bonn.org

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