Violent conflict can spell catastrophe for developing countries and their neighbors, stunting and even reversing the course of economic growth. Recent World Bank research on the causes of conflict and civil war finds that the countries most likely to be blighted by conflict are those whose economies depend heavily on natural resources. *Natural Resources and Violent Conflict: Options and Actions* first explains the links between resource dependence and conflict and then considers what can be done to help reduce the risk of civil war in these nations.

In this collection of previously unpublished essays by experts in the field, contributors consider the risks of corruption, secessionist movements, and rebel financing. They also consider the roles played by government, the development community, and the country’s population and propose an agenda for global action. Focusing on what we can do collectively to diminish the likelihood of civil war, contributors to this volume suggest practical approaches and policies that could be adopted by the international community—from financial and resource reporting procedures to commodity tracking systems and enforcement techniques, including sanctions, certification requirements, and aid conditionality. A fascinating look at the results of important new World Bank research, this book represents an important addition to the dialogue on development.
The World Bank does not guarantee the accuracy of the data included in this work. The boundaries, colors, denominations, and other information shown on any map in this work do not imply any judgment on the part of the World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries.

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1.2 Risks from Natural Resources
Recent research undertaken by the World Bank and others suggests that developing countries face substantially higher risks of violent conflict and poor governance if they are highly dependent on primary commodities. Revenues from the legal or illegal exploitation of natural resources have financed devastating conflicts in a large number of countries across regions. When a conflict erupts, it not only sweeps away decades of painstaking development efforts but also creates costs and consequences—economic, social, political, regional—that live on for decades. The outbreak of violent domestic conflict amounts to a spectacular failure of development—in essence, development in reverse. Even where countries initially manage to avoid violent conflict, large rents from natural resources can weaken state structures and make governments less accountable, often leading to the emergence of secessionist rebellions and all-out civil war.
Natural resources are never the sole source of conflict, and they do not make conflict inevitable. But the presence of abundant primary commodities, especially in low-income countries, exacerbates the risks of conflict and, if conflict does break out, tends to prolong it and makes it harder to resolve.

Reflecting a growing interest in the links between natural resources and conflict and the World Bank’s evolving conflict agenda—which is placing greater emphasis on preventing conflicts—in 2002, the World Bank’s Conflict Prevention and Reconstruction Unit and the Development Research Group began to define a research project to address this link. As the Governance of Natural Resources Project took shape, the discussion moved toward practical approaches and policies that could be adopted by the international community. While there is much that individual developing countries can do to reduce the risk of conflict—by addressing genuine grievances in their societies, adopting economic and social policies that are more inclusive, and improving transparency and accountability—there is also a need to articulate a convincing and practical agenda for global action. As members of the international community working to build a world that is safer and free of poverty, we share a global responsibility in assisting developing countries to ensure that revenues from the exploitation of natural resources do not exacerbate the risk of conflict.

This book presents the papers commissioned under the Governance of Natural Resources Project. When we commissioned this work, we asked the researchers to focus on the practical aspects from a global governance perspective—to focus on “what we can do collectively.” The papers offer a rich array of approaches and suggestions that are feeding into the international policy debate and that we hope will lead over time to concerted international action to help developing countries better manage their resource wealth and turn this wealth into a driver of development rather than of conflict.

The Governance of Natural Resources Project and the publication of this book have been made possible through the generous support of the government of Norway, which is funding the project through the Norwegian Trust Fund for Environmentally and Socially Sustainable Development. We are very grateful for this support and encouragement. We also wish to thank the Agence Française de Développement (AFD), especially Pierre Jacquet (AFD executive director and chief economist), Serge Perrin, and the rest of the staff of AFD, not only for hosting the workshop that launched the project in Paris in December 2002 but also for their continued interest, support, and encouragement.

The project has received strong support and valuable inputs from a wide range of stakeholders. We especially want to thank the partici-
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Within the Bank, the project has been a collaborative effort between the Conflict Prevention and Reconstruction Unit and the Development Research Group, with valuable and continuous support from the Oil and Gas Group, especially from Charles McPherson. We have also benefited from advice and guidance from many staff in the Bank, especially Nicholas Stern, Robert Bacon, Kerstin Canby, and Havard Hagre. A big thanks also to the authors of the research papers, who produced excellent chapters, despite having to work under very tight deadlines. Finally, a special thanks to Kazuhide Kuroda, not only for his conceptual and substantive contributions to the project but also for his tireless efforts to put it all together.

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Acronyms and Abbreviations

AUC
United Self-Defense Forces of Colombia
CCAMLR
Convention on the Conservation of Antarctic Marine Living Resources
CFF
Compensatory Financing Facility
CCSRP
Committee for the Control and Supervision of Oil
Resources
CFC
Chlorofluorocarbon
CITES
Convention on International Trade in Endangered Species of Fauna and Flora
COTCO
Cameroon Oil Transportation Company
CPIA
Country Policy and Institutional Assessment
CTR
Commodity-specific tracking regime
ECGD
Export Credit Guarantee Department (United Kingdom)
ECOMOG
ECOWAS Monitoring Group
ECOWAS
Economic Community of West African States
ELN
National Liberation Army, Colombia
EU
European Union
FAO
Food and Agriculture Organization of the United Nations
FARC
Revolutionary Armed Forces of Colombia
FATF
Financial Action Task Force on Money Laundering
FLEG
Forest Law Enforcement and Governance
FLEG-T
Forest Law Enforcement, Governance, and Trade
FLN
National Liberation Front, Algeria
FSAP
Financial Sector Assessment Program
FSC
Forest Stewardship Council
GAM
Gerakan Aceh Merdeka
GBIF
Global Biodiversity Information Facility
GDP
Gross domestic product
GeSI
Global e-Sustainability Initiative
HIPC
Highly Indebted Poor Countries
IFC
International Finance Corporation
IMF
International Monetary Fund
INTOSAI
International Organization of Supreme Audit Institutions
ITTO
International Tropical Timber Organization
LDC
Least developed country (United Nations grouping)
MIGA
Multilateral Investment Guarantee Agency
MMSD
Mining, Minerals, and Sustainable Development
MPLA
Popular Movement for the Liberation of Angola
MSC
Marine Stewardship Council
NEPAD
New Partnership for Africa’s Development
NGO
Nongovernmental organization
NPFL
National Patriotic Front of Liberia
OECD
Organisation for Economic Co-operation and Development
PEFC
Pan European Forest Certification Council
RCD
Congolese Assembly for Democracy
ROSC
Reports on the Observance of Standards and Codes
RUF
Revolutionary United Front, Sierra Leone
SLORC
State Law and Order Restoration Council
SOFAR
State Oil Fund for the Azerbaijan Republic
SPLA
Sudan People’s Liberation Army
TOTCO
T’Chad Oil Transportation Company
UN
United Nations
UNDP
United Nations Development Programme
UNEP
United Nations Environment Programme
UNITA
National Union for the Total Independence of Angola
WTO
World Trade Organization
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acronyms and abbreviations

chapter 1
Natural Resources and Conflict: What We Can Do
Ian Bannon and Paul Collier

Civil wars bestow most of the suffering on noncombatants, who tend to have little say in whether the conflict is initiated or if and when it is settled. As the conflict rages, incomes tend to plummet, mortality rises, and diseases spread. A generation’s worth of education can be lost as education systems collapse for all but the privileged few. Civil wars are not temporary glitches in an otherwise smooth development path—the direct and indirect costs during the conflict are typically so high that even when post-conflict progress is dramatic and sustained, it will take countries a generation or more just to return to prewar conditions. This is because many of the costs of the war continue to accrue long after the fighting has stopped: the peace dividend proves elusive as the government finds it difficult to cut military spending; violent crime tends to explode, affecting people and the investment climate; capital flight continues and private investors, local and foreign, remain skittish; the prevalence of epidemics and disease remains higher than before the war; and human and social capital, destroyed or frayed during the war, can take decades to recover. Although there may be a few cases where a successful rebellion has ushered in social progress or led to the downfall of an oppressive and predatory regime, the majority of civil wars produce a spectacular failure of development. For the
affected country, civil war represents development in reverse. The costs of conflict, however, do not stop at the borders of the unlucky country. Civil wars also affect the country’s neighbors and the global community. The costs suffered by other countries in the region may be as large as those suffered within the country, as the effects of the war spill across borders. The most obvious impact is through the creation of large numbers of refugees, who impose a heavy economic burden on the host country and, because of their conditions on arrival and the crowded and unsanitary conditions in camps, exacerbate the risks of infectious diseases such as malaria, tuberculosis, and HIV/AIDS. A civil war in the neighborhood also leads countries to raise their defense spending, often generating a regional arms race. Conflict disrupts regional trade and discourages foreign investors, who tend to regard the whole region as risky, even after the war has ended.

Civil war is also bad for the global community, especially in terms of three “global bads”: drugs, AIDS, and terrorism. The cultivation of hard drugs requires territory outside the effective control of government. One consequence of conflict is that large rural areas tend to fall outside government control, making it difficult, if not impossible, to mount effective eradication measures. Conflict is an important vector of HIV/AIDS. Prevalence rates tend to be higher in conflict countries due to the more risky sexual behavior of combatants, coupled with their living conditions, mobility, age, and isolation from family and communities (Elbe 2002). The large and often massive movements of population induced by conflict favor the spread of AIDS, complicating the efforts of the international community to control the pandemic. By creating territory outside the control of a recognized government, conflict also provides terrorist organizations the safe haven they need to flourish and mount their attacks.

Understanding the Drivers of Conflict

Although, like Tolstoy’s unhappy families, every conflict is unique in its own way, conflicts appear to embody recurring factors, which are often surprisingly strong. If reducing the risk of conflict is both necessary and possible, before we can propose measures to reduce the incidence of conflict we need to understand what makes countries vulnerable. Many models attempt to explore the factors that affect the risk of conflict (see, for example, Elbadawi and Sambanis 2002; Hegre and others 2001). In this chapter we review the results of the Collier-Hoeffler model and their findings on the links between natural resources and conflict (Collier and Hoeffler 2003). After testing for a number of factors, Collier and Hoeffler find that three are significant—the level of income per capita, rate of economic growth, and structure of the economy, namely, dependence on primary commodity exports. Doubling per capita income
roughly halves the risk of a civil war. Each additional percentage point of growth reduces the risk by about 1 percentage point. The effect of primary commodity dependence is nonlinear, peaking with exports at around 30 percent of gross domestic product (GDP). A country that is otherwise typical but has primary commodity exports around 25 percent of GDP has a 33 percent risk of conflict, but when such exports are only 10 percent of GDP, the risk drops to 11 percent (figure 1.1) Ethnic and religious composition also matters. Societies in which the largest ethnic group accounts for 45 to 90 percent of the population—which Collier and Hoeffler term “ethnic dominance”—have a risk of conflict about one-third higher. Other than in the case of ethnic dominance, ethnic and religious diversity actually reduces the risk of rebellion. Once a country has had a civil war, its risk of renewed conflict rises sharply, although this risk fades gradually over time at about 1 percentage point a year. The tools of war need to be financed, making civil war an expensive proposition. Governments have established defense sectors and funding sources that support them, but to assemble, equip, and maintain a fighting force, the rebel group must find a regular source of income. Before the end of the cold war, rebel groups typically were financed by one of the superpowers or by proxy regional powers. With the end of the cold war, rebel groups have had to look for alternative funding sources. So irrespective of the motivation of the rebellion, the rebel group must also become a business organization. Its main and pressing challenge is to secure funds in order to wage war. If it cannot overcome this financing problem, the rebel group will wither away or be capable of only limited and low-level violence—more of natural resources and conflict.  

Figure 1.1 Natural Resources and Conflict Risk in Low-Income Countries

<table>
<thead>
<tr>
<th>Primary commodity exports as a share of GDP</th>
<th>Risk of civil war (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>6%</td>
</tr>
<tr>
<td>10</td>
<td>11%</td>
</tr>
<tr>
<td>5</td>
<td>20</td>
</tr>
<tr>
<td>10</td>
<td>25</td>
</tr>
<tr>
<td>15</td>
<td>20</td>
</tr>
</tbody>
</table>
an irritant than a serious threat to an established government. Much of the economic analysis of rebellions tends to look for economic objectives, whereas much of the political literature generally ignores finance as a constraint. Yet finance is critical.

Natural Resources and Conflict: What Is the Link?

Unless a successful rebel organization is bankrolled by another country or an extensive and willing diaspora, it must generate income by operating some business activity alongside its military operations. The question then becomes the type of business activity in which a rebel group is likely to be competitive. Unfortunately, the obvious answer is that the rebel groups’ only competitive advantage is their large capacity for organized violence and mayhem. Since, for military reasons, rebel groups tend to be based in rural areas, they turn to business activities such as various forms of extortion and the exploitation and trade of primary commodities.

Where rural areas produce primary commodities with high economic rents, generally for export, it is a relatively simple matter for rebel groups to run an extortion racket, levying protection charges on producers or carrying out some of the trade themselves. The best-known examples are the conflict diamonds of Angola and Sierra Leone. Alluvial diamonds are particularly well suited as a business line for rebels because the technology is so simple that the group can directly enter the extraction process and diamonds are a small, high-value commodity that is easy to hide and transport and has a readily accessible international market. As Michael Ross discusses in chapter 2, a number of other commodities such as coltan, drugs, gold, and timber have, at various times, been linked with civil wars in developing countries. In the case of high-value agricultural exports, the rebel group is not directly involved in production but levies informal taxes on producers and traders. The most spectacular example is that of illegal drugs, which, because of their illegality, are very high value. But even lower-value export crops are sometimes the target of rebel extortion—the Revolutionary United Front in Sierra Leone started by levying informal taxes on coffee and only shifted its activities to diamonds once it was well established.

Some extractive industries require sophisticated technology, generally supplied by a multinational company. This, too, provides opportunities for extortion. Rebel groups can target foreign companies and threaten expensive infrastructure, such as an oil or natural gas
pipeline. As pointed out in chapter 2, a particularly remarkable recent
development is for rebel groups to raise finance by selling the advance
4
bannon and collier

rightstotheextractionofmineralsthattheydonotcontrol, but that they
intend to control. This method of financing the tools of war through the
sale of extraction rights is what Ross terms “booty futures.”
Violent secessionist movements are statistically much more likely if
the country has valuable natural resources, with oil being especially
dangerous. Examples include Aceh (Indonesia), Biafra (Nigeria),
Cabinda (Angola), Katanga (ex-Congo), and West Papua (Indonesia).
There is some evidence that rebel leaders greatly exaggerate the likely
gains from controlling the resources. This exaggeration is in part
strategic, as secessionist leaders simply seize on the resource issue to
build support for their movement. For example, leaders of the GAM
(Gerakan Aceh Merdeka) rebellion in Aceh propagated the notion that
secession would turn the province into another Brunei. Ross (2002)
estimates that this was more than a tenfold exaggeration. But leaders
themselves may also succumb to the glamour of the riches to be had
from natural resources and overestimate the likely windfalls.
The discovery of a new natural resource or a higher endowment of a
known resource greatly increases the risk of conflict in low-income
countries, especially if the resource is oil (figure 1.2). In many such
instances, ethnic cleavages can appear to cause the rebellion. In most
societies, wherever a valuable resource is discovered, some particular
natural resources and conflict
5
0
Risk of an
ideological
war
Risk of a
secessionist
war
3%
8%
2
4
6
8
10
Risk of civil war (percent)
Figure 1.2 Risks from Natural Resources
Additional Risk of Civil War When
the Natural Resource Endowment
Is Double the Average
Effect of Oil on the Type of War:
Risk that the War Is Secessionist

<table>
<thead>
<tr>
<th>Percent</th>
<th>Without oil</th>
<th>With oil</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>68%</td>
<td>100%</td>
</tr>
<tr>
<td>20</td>
<td></td>
<td></td>
</tr>
<tr>
<td>40</td>
<td></td>
<td></td>
</tr>
<tr>
<td>60</td>
<td></td>
<td></td>
</tr>
<tr>
<td>80</td>
<td></td>
<td></td>
</tr>
<tr>
<td>100</td>
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</tbody>
</table>

*Source: Based on Collier and others (2003).*

ethnic group is living on top of it and has an incentive to assert its rights to secede. All ethnically differentiated societies have a few romantics who dream of creating an ethnically “pure” political entity, but the discovery of resources has the potential to transform such movements from the romantic fringe into an effective and violent secessionist movement. Although this type of secessionist movement appears ethnically based and cloaks its justification in the rhetoric of ethnic grievances, it would seem a mistake to consider ethnicity or religion as the driver of conflict. Poor governance and corruption can also exacerbate secessionist tendencies, especially if the secessionist group has a fighting chance of wresting control of a valuable natural resource. Where a region sees what it considers its resources stolen by a corrupt national elite comfortably ensconced in the capital, the prospect of gaining control over the natural resource revenues and using them for the benefit of the local ethnic majority can be a powerful driver for a secessionist movement. Kidnapping for ransom targeted at foreign extractive companies also can be a profitable business. In the 1990s kidnapping became the third largest source of financing for Colombia’s two rebel groups (National Liberation Army and Revolutionary Armed Forces of Colombia), after drugs and extortion. Kidnapping netted the Colombian guerrillas an estimated $1.5 billion during 1991–99, and these revenues have been rising. In 1999 the two groups are estimated to have received a combined $560 million from extortion and kidnapping (Pax Christi Netherlands 2001, pp. 33–34). A large number of kidnap victims are employees of foreign extractive industries. Oil companies are especially frequent kidnap targets, and in some regions kidnapping has become a regular routine for them. Rebel groups may also target foreign tourists for kidnapping, as has happened in the Philippines.
Following each successful kidnapping, rebel recruitment soars, presumably because young men anticipate large payoffs. In Colombia rebel groups have combined with urban-based criminals to create a market in kidnapped people. Criminals undertake the kidnapping, selling the victim to the rebel group, which then demands ransom. Just as markets have emerged in some developing countries to trade kidnap victims, markets have emerged in developed countries to supply ransom insurance. Kidnap insurance, although understandable from a personal or business sense, has the perverse effect of reducing the incentive to protect workers from kidnapping, increasing the size of ransom payments, and lowering the transaction costs for the rebel group. In Colombia rebels are reputed to have, at times, gained access to insurance company data and thus been able to determine whether the actual or intended victim has kidnap insurance (Pax Christi Netherlands 2001, p. 30).

Wars also appear to have been lasting longer. The expected duration of conflict is now more than double that of conflicts that started prior to 1980 (Collier, Hoeffler, and Söderbom 2001). We do not know why this is the case, but one possible explanation is that it is now easier to sustain a conflict than it used to be. Even without support from a superpower or from a neighboring government, it is possible to find alternative sources of revenue with which to equip and sustain rebel movements.

Once conflict breaks out, it tends to make matters worse through its effect on the structure of the economy. Many natural resource exports are relatively unaffected by conflict because they have high rents or operate in enclave-type settings, with minimal backward or forward linkages with the rest of the economy. Contrast this with manufacturing or service activities such as tourism, which tend to have low margins and are easily disrupted by conflict. Moreover, economic policies and institutions, which are key to economic diversification, deteriorate markedly during the conflict and take a very long time to recover. As a result, countries are likely to find themselves even more dependent on natural resources than before the conflict started. This makes conflict much harder to resolve and, when resolved, raises the risk of a return to war.

A Call for Global Action

More than a billion people live in low-income countries that have been unable to put in place and sustain policies and institutions that would allow them to join the group of more developed middle-income nations. These countries have generally been mired in economic decline and dependent on primary commodities. This group faces a high risk of civil war, which, if it materializes, sets them on a path of reverse
development. Close to 50 armed conflicts active in 2001 had a strong link to natural resource exploitation, in which either licit or illicit exploitation helped to trigger, intensify, or sustain a violent conflict. In other countries with low-intensity conflict or collapsed states, corrupt officials and their opponents, often involved with organized crime and terrorist networks, siphoned off revenues from natural resources. In addition to sustaining conflict and undermining governance, resource exploitation has contributed to famines, the spread of diseases, population displacement, and serious environmental damage. Abundant natural resources, which should be a blessing for a low-income country, in most cases make poor people poorer.

The adverse effects of natural resource endowments flow through a variety of channels, but most of these are amenable to policies and natural resources and conflict

concerted global action. Some of the actions needed to avoid civil wars must come from the governments of developing countries themselves—for example, by making greater efforts to adopt economic policies and institutions that can stimulate growth and reduce poverty, improve governance and transparency, and redress reasonable grievances. Some measures, however, require concerted global action.

Building a more peaceful world is not just a matter of encouraging tolerance and consensus. It should involve a practical agenda for economic development and the effective global governance of the markets that have come to facilitate rebellion and corrupt governance. In the remainder of this chapter, we consider measures that can be regarded as part of a global development agenda and measures that are more appropriately viewed as part of the global governance of natural resources and its link to conflict.

The Development Agenda

Successful development is the best protection against civil war. In particular, raising and sustaining economic growth, diversifying the economy, and assisting countries to cope more effectively with commodity price shocks can all help to reduce the risk of conflict in low-income countries.

**Raising Economic Growth.** Faster economic growth would reduce the risk of conflict by raising the level of income and, indirectly over time, assisting diversification. The key issue is how to raise growth. There is a broad consensus that three instruments—domestic policies, international aid, and access to global markets—are all effective in raising growth.

1 The precise way in which they operate is subject to debate, but there is no significant disagreement on the merits of market access. Some analysts argue that aid and policies complement each other, with
aid becoming more effective as policies get better and, conversely, policy reform being more effective as inflows of aid become larger. Other analysts argue that the beneficial effects of aid and policy are independent. The common ground is that, where policies are reasonable, aid is effective and that, where policies are not reasonable, policy improvement will enhance growth. The intention is not to enter into these arguments here but merely to assert that the old dictum of “good policies supported by generous aid and access to markets” remains an effective longer-term strategy for preventing conflicts.

_Diversifying out of Trouble._ One obvious way to reduce countries’ dependence on natural resources is to help them to diversify their economies. Countries with a more diverse base of exports are better protected from the adverse effects of price fluctuations and less prone to the resource curse. On average, developing-country exports are no longer predominantly primary commodities. But this average masks a skewed pattern—at one extreme, the successful developers that have achieved astonishingly rapid diversification and, at the other, a group of low-income countries that have been left behind by development and marginalized from world markets. The fact that the former group has succeeded shows that it is possible for the marginalized to do the same; however, diversification may not always be a realistic or even a desirable option—Botswana is a landlocked desert with few options other than diamonds. For such countries, the priority should be to make natural resource endowments work effectively for development, as Botswana has managed to do. But for many countries, diversification is surely a viable option.

Three factors significantly reduce a country’s dependence on primary commodities: growth, aid, and policy. On average, growth diversifies an economy, which reduces the risk of conflict in addition to the direct contribution of growth to risk reduction. This does not imply that all policies that promote growth promote diversification, but there is some presumption that the inducement of growth will normally assist diversification. Aid significantly reduces primary commodity dependence. This may be partly a result of “Dutch disease,” which, by increasing the availability of foreign exchange, leads to appreciation of the exchange rate and thus reduces export incentives. Aid may also improve infrastructure—transport, power, telecommunications—which can help to lower business costs and improve the international competitiveness of activities that do not rely on high location-specific rents for their profitability. Good economic policy also significantly promotes diversification. Collier and Hoeffler (2003) measure this using the World Bank’s Country Policy and Institutional Assessment (CPIA) ratings. On aver-
age, an improvement of 1 point in the CPIA—roughly equivalent to the difference between African and South Asian policies—would reduce primary commodity dependence from 15.2 percent of GDP to 13.8 percent.

As pointed out in chapter 2, OECD (Organisation for Economic Co-operation and Development) countries can also help natural resource-dependent, low-income countries to diversify by removing tariff and nontariff barriers on value added goods. OECD countries place no tariffs on imports of unprocessed oil and minerals, but exporters quickly run into tariffs and nontariff barriers if they wish to add value to these raw materials.

Reducing Exposure to Price Shocks. Many of the problems caused by resource dependence come from the volatility of international prices. Natural resources and conflict

Primary commodity prices are highly volatile so that countries that are heavily dependent on primary commodities periodically suffer from crashes in export prices. Studies show that commodity price shocks tend to promote corruption, weaken state institutions, and create a host of budget and management problems (see chapter 2). This is, in part, because shocks produce a multiplier contraction in output and severe fiscal pressures that do not disappear when prices recover. Recent research finds that when these shocks are large, they severely damage medium-run growth—each dollar of export income lost generates a further two dollars of output contraction (Collier and Dehn 2001).

There is also some evidence that much of this lost growth is never recovered. Hence, negative price shocks may induce episodes of rapid and persistent economic decline that increase the risk of conflict. Governments of low-income, shock-prone countries face macroeconomic management problems on a scale that developed countries have not seen since the 1930s. Yet their plight has received scant attention from donors. Shocks caused by natural disasters—earthquakes, hurricanes, floods, droughts—typically produce a massive and generous donor response, often overcompensating for the shock itself. Price shocks, such as the one being experienced by coffee producers today, although often much more devastating, have historically triggered no significant donor response. Until recently, the international community had two instruments to address the problem: the Compensatory Financing Facility (CFF) of the International Monetary Fund (IMF) and the Stabex Facility of the European Union (EU). For different reasons, neither of these worked well, and they are both dormant. The CFF was a nonconcessional borrowing facility, yet it is usually unwise for a country to borrow commercially at the onset of a severe negative shock. Stabex disbursements were so slow that they tended to be procyclical, arriving during the following price upturn.
Even the governments of developed countries, with sophisticated teams of experts, would find the management of such large shocks extremely difficult. Developing-country governments usually lack the expertise and political leeway to implement contractionary policies effectively. There is therefore a case for global action to cushion such shocks and assist countries to improve their risk management or transfer some of this risk. International financial institutions, especially the IMF and World Bank, could consider redesigning existing tools or developing new mechanisms to reduce the impact of price shocks. Beyond cushioning price shocks, there is also reason to reduce them where possible. Attempts to control commodity prices have failed repeatedly, and there seems to be little reason to propose them once again. However, the trade policies of countries in the OECD (Organisation for Economic Co-operation and Development) can exacerbate volatility for other countries. When OECD governments increase their subsidy to domestic producers in order to cushion them from a fall in the world price of an agricultural commodity, the effect is to amplify price shocks for the rest of the world. The cushioning that such subsidies provide to domestic OECD producers comes at the cost of increasing the price volatility for producers in low-income countries—precisely those that can ill-afford negative shocks and have few ways of softening the fall in prices.

The Governance of Natural Resources

Many low-income countries depend on primary commodities for their export and fiscal revenues. On average, such dependence is associated with increased risk of conflict, weak governance, and poor economic performance. However, the average conceals extremely wide variation. In 1970 Botswana and Sierra Leone were both low-income countries with substantial diamond resources. Over the next 30 years diamonds were central to the economic and social collapse of Sierra Leone—its per capita income is now much lower than it was in 1970, and the country has sunk to the bottom of the Human Development Index. By contrast, diamond resources were critical to Botswana’s success in becoming the fastest-growing economy in the world and a middle-income country. Hence, although on average primary commodities have been a bane on development, they can also drive successful development. The natural resource curse is not destiny. The challenge, at both the national and international levels, is to adopt policies that better harness this potential.

The vast majority of resources that sustain and fuel civil wars depend on access to the global economy—to its markets, its financial intermediaries, its brokers, its investors, and the foreign companies that
often extract a developing country’s riches. This is not to decry the impact of globalization and add to the litany of negative effects ascribed to it. On the contrary, while globalization provides rebels with new opportunities, it also makes them more vulnerable to international pressure—more than would have been possible when rebellions were proxy wars of the superpowers—provided the international community is willing to exert it. The remainder of this chapter sketches out broad areas where global action would be effective, while the other chapters in this book explore each area in greater depth.

natural resources and conflict

Who Gets the Money? Increasing Transparency of Natural Resource Revenues. Although these proposals for global action are directed primarily at the international community, governments of low-income, resource-rich countries should also have a strong interest. They are often under threat from rebel groups financed by natural resource revenues and would obviously benefit if these funding sources were choked off. But these governments need to show that their natural resource revenues are well used. As discussed, rebel movements, particularly those seeking to secede on the back of natural resources, are greatly bolstered by the presence of a corrupt elite that siphons off the revenues rather than a government that uses them transparently to raise living standards across the board. The government’s best defense is likely to be credible scrutiny of the revenues that it receives, how they enter the budget, and how they are spent. There are two serious obstacles, however, even when governments aim to be accountable. First are the sheer magnitude of resource revenues and the scale of the rents relative to the size of the country’s economy. Governments in low-income countries, with poor institutional capacity and little tradition of accountability and public scrutiny, face enormous problems in absorbing and effectively tracking large revenue flows. This is not to exempt or excuse corruption in resource-abundant countries but merely to indicate the scale of the pressures and hence temptations involved. Second, in many instances it is not enough for resources to be accounted for and relatively well used—the government is not fully trusted and so will need to convince doubters by establishing a credible independent process of verification. These two factors suggest that even countries wanting to do the right thing need help, which, if successful, may exert pressure on those governments that do not manage their resource wealth effectively.

One possible way to address these issues in an integrated way is to develop an international template for the acceptable governance of natural resource revenues to which a resource-rich government could
choose to subscribe. Such a template would have five elements. First, the host government would require international companies in the extractive industries to report payments so as to allow appropriate scrutiny and international comparability. Such reporting could either be to the general public, as envisaged in the Publish What You Pay campaign discussed by Philip Swanson, Mai Oldgard, and Leiv Lunde in chapter 3, or to an independent entity such as the international financial institutions. Second, the government itself would require national resource extraction companies, whether private or government owned, to report on the same basis. Third, the government would undertake to report its receipts from all of the above sources and ensure that they are easily tracked as they pass through the budget. Fourth, an independent entity, such as the international financial institutions, would collate the reported information, attempt to reconcile payments and receipts, integrate the figure for net government revenues with standard budget information on revenues and expenditures, and publish the results on an annual basis. A natural division of labor would be for the World Bank to collate, reconcile, and aggregate the data from companies and for the International Monetary Fund to integrate the net revenues into the budget data it already scrutinizes under its arrangements or Article IV consultations. Fifth, the government would designate and, if necessary, establish credible domestic institutions of scrutiny—such as parliamentary committees or ad hoc entities, including civil society organizations, as in Chad—to which the international financial institutions could report the information in a form that would be readily intelligible.

Where Does It Come from and Who Buys It? Shutting Rebel Organizations out of Markets. The Kimberley Certification Process Scheme is designed to make it increasingly difficult for rebel organizations to sell rough diamonds in global markets. The process, which took only two years to establish (a comparatively short time for a global initiative), is an important first step. As Corene Crossin, Gavin Hayman, and Simon Taylor discuss in chapter 4 and appendix 4.1, significant technical and operational issues remain to be addressed, and it is too early to judge whether the Kimberley process will be successful and sustained. However, it is an encouraging sign that this type of global action is indeed possible.

If the Kimberley process proves ineffective, the present private voluntary agreement will need to be reinforced by intergovernmental legislation and probably provide for enforceable sanctions. However, the existence of the private agreement shows that all parties have recognized the need for effective action and deserve the opportunity to
demonstrate success. Moreover, if the Kimberley process is successful, it could form the model for the governance of other commodities for which there is significant inadvertent funding of conflict. Realistically, the effect of better regulation of commodity markets is not to shut rebel organizations out of markets altogether. Efforts such as the Kimberley process for rough diamonds, chain-of-custody tracking arrangements for illegal logging, and other schemes discussed in chapter 4 can be effective even if rebels are still able to sell the commodities they extort from local producers, as long as they can sell these illegal commodities only at a deep price discount. In this respect, a key global action is to monitor and evaluate the Kimberley process, natural resources and conflict

while developing and implementing certification and tracking schemes for other commodities. GoingaftertheMoney:TheFinanceofIllicitCommodities. A practice that financed several rebel organizations in the 1990s is the sale of booty futures, whereby a rebel organization receives finance in advance in return for an entitlement to natural resource extraction in the future should the rebellion succeed. Reputable companies rightly view this practice as unacceptable; nevertheless, it happens on the fringes of the corporate world. As Philippe Le Billon discusses in chapter 6, there is a strong case for making such transactions criminal in the company’s home country, analogous to the OECD agreement to criminalize international bribery. Extortion and kidnapping have also become an important source of financing for rebel movements, and, as discussed earlier, the financial flows involved can be considerable. Although companies should be discouraged from operating in such conditions, the insurance industry has developed products offering ransom insurance. The overall effect of this is evidently to increase ransom payments, and there is a good case for banning ransom insurance. OECD governments could also undertake and live up to a commitment that public money will not be used to pay ransom to rebel movements and, correspondingly, that extortion payments will not be treated as tax-deductible business expenses. There is also a strong case for OECD countries to consider antidrug policies that reduce financial flows to rebel groups. Tightening Scrutiny on Illicit Payments. The proposed template is intended to ensure that legitimate payments from companies to governments are properly accounted for and used. Illicit payments by natural resource extraction companies to bribe people of influence are a different problem. The OECD agreement to criminalize such payments is a start, but bribes to officials can be disguised as “facilitation payments” to companies controlled by their relatives, and so complementary
efforts are required. Some resource extraction companies, in line with OECD Guidelines for Multinational Enterprises, have now undertaken not to make facilitation payments. It would be desirable to make greater efforts to encourage adoption by non-OECD countries (chapter 6) but also to encourage the industry to determine precisely what is the boundary between legitimate and illegitimate payments and to embed this in corporate rules of behavior.

There is also an important role for the international banking system. The family of President Abacha was able to deposit in reputable international banks sums vastly in excess of his presidential salary, evidently illegally siphoned off from Nigerian oil revenues. Banks now have somewhat greater responsibility to know their clients and to report suspect receipts. There is also increasingly greater cooperation in securing the repatriation of corrupt money. However, there is scope for much tighter reinforcement of antibribery legislation on the part of the international banking system. As Jonathan Winer and Trifin Roule propose in chapter 5, the Financial Action Task Force should consider extending its recommendations to the exploitation of drugs or any other form of trade in illicit natural resources.

In some cases, even the best scrutiny and information on the dealings of corrupt officials and politicians will have no effect. Leaders and politicians may be impervious to moral pressure or wield sufficient power to place them above their own national law. In such cases the international community has some responsibility to impose penalties that target the guilty party and his or her associates without inflicting suffering on the society. The United Nations has been developing smart sanctions that offer some scope for such a targeted approach to penalties. These types of sanctions should be strengthened and internationally supported.

Attracting Reputable Companies to Risky Environments. At present, some low-income countries face severe difficulties in attracting reputable resource extraction companies to exploit their resources. When reputable resource extraction companies withdraw from difficult environments as a result of greater international public scrutiny, they may well be replaced by companies that are less reputable or less vulnerable to international pressure or shareholder concerns. In this case, global efforts would be counterproductive. As John Bray discusses in chapter 7, survey evidence suggests that the two main impediments deterring good companies from entering very risky environments are the risk to their reputations and the political risk of unreasonable treatment. The template described in this chapter has the potential to address both of these risks.

One advantage of the Chad-Cameroon pipeline model of improved
The governance of natural resource revenues is that it provides international companies with a degree of reputational protection. The international financial institutions in effect certify a governance structure as acceptable. The introduction of a more standardized template for appropriate governance, and its adoption by governments interested in attracting reputable companies, would provide a much higher degree of reputational cover. Such a template also has the potential to address political risk. At present, the insurance entities that supply cover for political risks, such as the World Bank Group’s Multilateral Investment Guarantee Agency (MIGA), have to assess each governance situation entirely on an ad hoc basis. Where governments subscribe to the good governance template, this would be pertinent information for MIGA and other insurers and could considerably facilitate their willingness to provide cover.

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Note
1. An additional issue, not discussed here, is whether the way of raising growth inadvertently increases the risk of conflict. Collier and Hoeffler (2003) find that policies that raise growth rates do not directly increase the risk of conflict.

References
The word “processed” describes informally produced works that may not be commonly available through libraries.


chapter 2
The Natural Resource Curse:
How Wealth Can Make You Poor
Michael Ross
S
INCE THE MID-1990
S THERE HAS BEEN
agrowing body of research on the
causes of civil wars. One of the most surprising and important findings
is that natural resources play a key role in triggering, prolonging, and
financing these conflicts. This report summarizes the main findings of
recent scholarship on the role of natural resources in civil wars and
discusses some policy options.

The natural resources that cause these problems are largely oil
and hard-rock minerals, including coltan, diamonds, gold, and other
gemstones. Sometimes other types of resources are also at fault—
notably timber. And if drugs are considered a natural resource, they
too have played an important role in several conflicts. Table 2.1 lists
17 recent conflicts that are linked to natural resources. In eight of
these, gemstones are one of the resources; in six, the resource is oil
or natural gas; in five, it is some type of illicit drug; and in three
cases, it is timber. In most of the conflicts, multiple resources play
a role.

Resource-related conflicts may pose special problems for the states
of Africa. Of the 17 resource-related conflicts in table 2.1, nine are in
Africa. Moreover, conflicts in Africa, of all the world’s regions, show the
most worrisome trends. Between 1992 and 2001 the number of armed
conflicts outside of Africa dropped by half, yet the number of conflicts
in Africa stayed roughly the same (table 2.2). Moreover, within Africa,
armed conflicts have grown more severe. During the 1970s and 1980s,
half of all intrastate conflicts in Africa could be classified as civil
wars—that is, they generated at least 1,000 battle-related deaths each
year. In the 1990s two-thirds of Africa’s intrastate conflicts were civil
Table 2.1 Civil Wars Linked to Resource Wealth, 1990–2002

<table>
<thead>
<tr>
<th>Country</th>
<th>Duration</th>
<th>Resources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Afghanistan</td>
<td>1978–2001</td>
<td>Gems, opium</td>
</tr>
<tr>
<td>Angola</td>
<td>1975–2002?</td>
<td>Oil, diamonds</td>
</tr>
<tr>
<td>Angola (Cabinda)</td>
<td>1975–</td>
<td>Oil</td>
</tr>
<tr>
<td>Cambodia</td>
<td>1978–97</td>
<td>Timber, gems</td>
</tr>
<tr>
<td>Colombia</td>
<td>1984–</td>
<td>Oil, gold, coca</td>
</tr>
<tr>
<td>Congo, Rep. of</td>
<td>1997</td>
<td>Oil</td>
</tr>
<tr>
<td>Indonesia (Aceh)</td>
<td>1975–</td>
<td>Natural gas</td>
</tr>
<tr>
<td>Indonesia (West Papua)</td>
<td>1969–</td>
<td>Copper, gold</td>
</tr>
<tr>
<td>Liberia</td>
<td>1989–96</td>
<td>Timber, diamonds, iron, palm oil, cocoa, coffee, marijuana, rubber, gold</td>
</tr>
<tr>
<td>Morocco</td>
<td>1975–</td>
<td>Phosphates, oil</td>
</tr>
<tr>
<td>Myanmar</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

michael ross
1949–
Timber, tin, gems, opium
Papua New Guinea
1988–
Copper, gold
Peru
1980–95
Coca
Sierra Leone
1991–2000
Diamonds
Sudan
1983–
Oil

Note: Separatist conflicts are listed in italics.

Table 2.2 Armed Conflicts in Africa and the Rest of the World, 1989–2001

<table>
<thead>
<tr>
<th>Year</th>
<th>Africa</th>
<th>Rest of world</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989</td>
<td>14</td>
<td>33</td>
</tr>
<tr>
<td>1990</td>
<td>17</td>
<td>32</td>
</tr>
<tr>
<td>1991</td>
<td>17</td>
<td>34</td>
</tr>
<tr>
<td>1992</td>
<td>15</td>
<td>40</td>
</tr>
<tr>
<td>1993</td>
<td>11</td>
<td>35</td>
</tr>
<tr>
<td>1994</td>
<td>13</td>
<td>29</td>
</tr>
<tr>
<td>1995</td>
<td>9</td>
<td>26</td>
</tr>
<tr>
<td>1996</td>
<td>14</td>
<td>14</td>
</tr>
<tr>
<td>1997</td>
<td>22</td>
<td>14</td>
</tr>
</tbody>
</table>
Table 2.3 Civil Violence in Africa by Decade, 1970–99

<table>
<thead>
<tr>
<th>Period</th>
<th>Minor conflict a</th>
<th>Intermediate conflict b</th>
<th>Civil war c</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970–79</td>
<td>5</td>
<td>2</td>
<td>7</td>
</tr>
<tr>
<td>1980–89</td>
<td>8</td>
<td>0</td>
<td>8</td>
</tr>
<tr>
<td>1990–99</td>
<td>6</td>
<td>1</td>
<td>14</td>
</tr>
</tbody>
</table>

a. A minor conflict produces at least 25 battle-related deaths per year and fewer than 1,000 battle-related deaths over the course of the conflict.
b. An intermediate conflict produces at least 25 battle-related deaths per year and an accumulated total of at least 1,000 deaths, but fewer than 1,000 in any given year.
c. A civil war produces at least 1,000 battle-related deaths per year.

Source: Data are taken from Gleditsch and others (2001).

Wars. Africa had seven civil wars in the 1970s, eight in the 1980s, and 14 in the 1990s (table 2.3).

Before proceeding, it is useful to clarify two facts. First, natural re-
sources are never the only source of a conflict. Any given conflict is brought about by a complex set of events; often poverty, ethnic or religious grievances, and unstable governments also play major roles. But even after these factors have been taken into account, studies consistently find that natural resources heighten the danger that a civil war will break out and, once it breaks out, that the conflict will be more difficult to resolve. Second, natural resource dependence never makes conflict inevitable. Resource wealth raises the danger of civil war, but for every resource-rich country that has suffered from violent conflict, two or three have avoided it. Better policies may help to reduce the likelihood that resources will generate conflict and to direct resource wealth instead to education, health, and poverty reduction.

This chapter presents an overview of what recent scholarship can tell us about the role that natural resources play in civil wars. It suggests four main pathways through which resources lead to armed conflict: their effects on economies, their effects on governments, their effects on people living in resource-rich regions, and their effects on rebel movements. It offers some examples of each dynamic and discusses ways in which the international policy community could intervene to counteract these effects.

1 Resource Dependence and Economic Performance
Resource dependence tends to make countries more susceptible to civil war through two economic effects: a reduction in growth and an increase in poverty.

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Economic Growth
It may seem paradoxical that a “gift” from nature of abundant gemstones, gold, or oil tends to cause economic distress. Yet study after study has found that resource-dependent economies grow more slowly than resource-poor economies.

2 A recent report by the World Bank, for example, looks at the economic performance in the 1990s of countries that have large mining sectors (World Bank 2002).

3 It finds that in countries with medium-size mining sectors (between 6 and 15 percent of all exports), gross domestic product (GDP) per capita fell at an average rate of 0.7 percent a year over the course of the decade. In countries with large mining sectors (between 15 and 50 percent of exports), GDP per capita dropped an average of 1.1 percent a year, while in countries with very large mining sectors (over 50 percent of exports) GDP per capita dropped a remarkable 2.3 percent a year. Collectively
these mining states saw their GDP per capita fall 1.15 percent a year—
a drop over the course of the decade of almost 11 percent (World Bank
2002; see also Ross 2002c).
This is a catastrophic record on economic grounds alone. But it also
has implications for the susceptibility of these states to civil war: re-
cent scholarship shows that when a country’s growth rate turns nega-
tive, a civil war is more likely to break out (Collier and Hoeffler 2001;
Hegre 2002). In the three years leading up to the war in the Democra-
tic Republic of Congo, for example, GDP growth averaged −5.56 per-
cent; in the three years before the Congo Republic’s civil war, growth
was −1.94 percent; on the eve of Liberia’s civil war, growth averaged
−1.34 percent (figures are from World Bank 2001).

Poverty
A country’s reliance on nonfuel mineral exports—and possibly oil
exports as well—also tends to create atypically high poverty rates.
One reason for this pattern is that resource-rich governments do an
unusually poor job of providing education and health care for their
citizens. Ross (2001b) finds a strong correlation between greater de-
pendence on oil and mineral exports and higher child mortality rates:
for each increase in minerals dependence of five points, the mortality
rate for children under the age of five rose 12.7 per 1,000; for each
five-point increase in oil dependence, the under-five mortality rate rose
3.8 per 1,000.

Again, this pattern is intrinsically worrisome, but it also has conse-
quences for a state’s susceptibility to violent conflict. The greater a
country’s poverty, the more likely it is to face a civil war (Collier and
Hoeffler 2001; Elbadawi and Sambanis 2002; Fearon and Laitin 2002).

A glance at the world’s most oil-dependent states, and most mineral-
dependent states, illustrates these patterns. Table 2.4 lists the world’s 20
most mineral-dependent states. Remarkably, the World Bank classifies
Table 2.4 Resource Dependency: Nonfuel Mineral–Dependent
States and Oil-Dependent States

<table>
<thead>
<tr>
<th>Minerals</th>
<th>Oil</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rank</td>
<td>State</td>
</tr>
</tbody>
</table>

It is not surprising that people are more likely to rise up against their
government when their economic predicament is bad and getting
worse. Rebel groups find it easier to recruit new members when poverty
and unemployment are widespread, since the prospect of combat and
looting seems more attractive by comparison.

21
<table>
<thead>
<tr>
<th>Rank</th>
<th>State</th>
<th>Dependence</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Botswana</td>
<td>35.1</td>
</tr>
<tr>
<td>2</td>
<td>Angola</td>
<td>68.5</td>
</tr>
<tr>
<td>3</td>
<td>Sierra Leone</td>
<td>28.9</td>
</tr>
<tr>
<td>4</td>
<td>Kuwait</td>
<td>49.1</td>
</tr>
<tr>
<td>5</td>
<td>Zambia</td>
<td>26.1</td>
</tr>
<tr>
<td>6</td>
<td>United Arab Emirates</td>
<td>46.3</td>
</tr>
<tr>
<td>7</td>
<td>Mauritania</td>
<td>18.4</td>
</tr>
<tr>
<td>8</td>
<td>Bahrain</td>
<td>16.4</td>
</tr>
<tr>
<td>9</td>
<td>Congo, Rep. of Brazzaville</td>
<td>40.9</td>
</tr>
<tr>
<td>Country</td>
<td>Rank</td>
<td>GDP</td>
</tr>
<tr>
<td>---------------------</td>
<td>------</td>
<td>-------</td>
</tr>
<tr>
<td>Guinea</td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td>Liberia</td>
<td>9</td>
<td>12.5</td>
</tr>
<tr>
<td>Oman</td>
<td></td>
<td>39.5</td>
</tr>
<tr>
<td>Niger</td>
<td>9</td>
<td>12.2</td>
</tr>
<tr>
<td>Gabon</td>
<td>10</td>
<td>36.1</td>
</tr>
<tr>
<td>Chile</td>
<td>11</td>
<td>11.9</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>12</td>
<td>34.3</td>
</tr>
<tr>
<td>Guinea</td>
<td>11</td>
<td>11.8</td>
</tr>
<tr>
<td>Qatar</td>
<td>12</td>
<td>33.9</td>
</tr>
<tr>
<td>Congo, Dem.</td>
<td>13</td>
<td>7.0</td>
</tr>
<tr>
<td>Algeria</td>
<td>14</td>
<td>23.5</td>
</tr>
<tr>
<td>Rep. of Jordan</td>
<td>13</td>
<td>6.3</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>15</td>
<td>21.9</td>
</tr>
<tr>
<td>Bolivia</td>
<td>15</td>
<td>5.8</td>
</tr>
<tr>
<td>Libya</td>
<td>15</td>
<td>19.8</td>
</tr>
<tr>
<td>Togo</td>
<td></td>
<td>5.1</td>
</tr>
<tr>
<td>Iraq</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
19.4
16
Central African
4.8
Venezuela
18.3
Republic
a
17
Peru
4.7
Norway
13.5
18
Ghana
a
4.6
Syria
13.5
19
Bulgaria
4.0
Ecuador
8.6
20
Angola
a
3.6
Bhutan
6.8

Note: Bold signifies a civil war since 1990. Mineral dependence is the ratio of non-fuel mineral exports to GDP. Oil dependence is the ratio of oil, gas, and coal exports to GDP. Figures are for 1995.
a. Defined by the World Bank as a highly indebted poor country.

12 of the 20 as “highly indebted poor countries”—the most troubled category of states—even though they earn large sums of foreign exchange from the sale of their resources. Since 1990, five of them have had civil wars. Table 2.4 also lists the world’s 20 most oil-dependent states. Here, too, the record is grim. Three of the top six states are classified as highly indebted poor countries, and, once again, five of the 20 suffered from civil wars in the 1990s.
The international community could take two types of measures that would help resource-rich economies. These suggestions and the others in this chapter are preliminary ideas only, designed to stimulate further analysis and discussion.

Promote Diversification through Trade Liberalization. One way to reduce the dependence of governments on resource revenues is to help them to diversify economically. States with more diverse exports are better protected against international market fluctuations and are less prone to the resource curse. For oil and mineral exporters, one obvious route to diversification is to develop downstream industries, which can process and add value to raw materials. Many downstream enterprises use large numbers of low-wage workers and, hence, offer special opportunities to the poor.

Yet downstream industries in oil- and mineral-dependent states rarely succeed. One reason is that the advanced industrial states place higher tariffs on processed goods than on raw materials to protect their own manufacturing firms against competition. The states in the Organisation for Economic Co-operation and Development (OECD) place no tariffs at all on the import of much unprocessed oil and many minerals, including aluminum, copper, crude oil, lead, nickel, tin, and zinc. Yet if oil- and mineral-rich countries wish to add value to these raw materials and export them in refined or processed form—such as aluminum kitchenware, copper wire, or plastic resins—they quickly run into OECD tariffs and nontariff barriers (table 2.5). By removing the tariffs and nontariff barriers to value added goods, the OECD states could help the resource-dependent states to diversify.

Find Better Ways to Reduce Revenue Volatility. Many of the problems caused by resource dependence come from the volatility of resource revenues. For the last century, the international prices for primary commodities—including oil and minerals—have been more

<table>
<thead>
<tr>
<th>Product and description</th>
<th>Tariff</th>
</tr>
</thead>
<tbody>
<tr>
<td>Copper ores and concentrates</td>
<td>0.00</td>
</tr>
<tr>
<td>Wire of refined copper, if maximum cross-sectional dimension exceeds 6 millimeters</td>
<td>4.06</td>
</tr>
<tr>
<td>Tubes and pipes of refined copper</td>
<td></td>
</tr>
</tbody>
</table>
4.12
Cooking or heating apparatus used for domestic purposes
3.98
Aluminum
  Aluminum ores and concentrates
  0.00
  Unwrought aluminum (not alloyed)
4.10
  Wire of aluminum, if maximum cross section exceeds 7 millimeters
6.13
  Table or kitchenware of aluminum
5.83
Lead
  Lead ores and concentrates
  0.00
  Refined lead
1.88
  Lead tubes, pipes, and fittings
3.90
Nickel
  Nickel ores and concentrates
  0.00
  Nickel bars, rods, and profiles (not alloyed)
  0.33
  Tubes and pipes of nickel (not alloyed)
  0.31
  Cloth, grill, and netting of nickel wire
  0.77
Tin
  Tin ores and concentrates
  0.00
  Tin rods, bars, profiles, and wire
  0.36
  Tin tubes, pipes, and fittings
  0.40
Zinc
  Zinc ores and concentrates
  0.00
  Refined zinc (containing by weight 99.99 percent or more of zinc)
  1.80
  Zinc bars, rods, profiles, and wire
  3.84
  Zinc tubes, pipes, and pipe fittings
  3.92
Petroleum
Petroleum oils, crude oil
Petroleum resins, coumarone, indene, or coumarone-indene resins, and polyterpenes
Woven fabrics made from high-tenacity yarn of nylon or other polyamides or of polyesters
Polyethylene (used for grocery bags, shampoo bottles, children’s toys)
Polymers of vinyl chloride (PVC plastic)
Polycarbonates (used for light fittings, kitchenware, and compact disks)

Source: UNCTAD-TRAiNS database (United Nations Conference on Trade and Development Trade Analysis and Information System); available at www.unctad.org/trains/index.htm [consulted June 1, 2001].

volatile than the prices for manufactured goods (Grilli and Yang 1988). Since 1970 this volatility has grown worse (Reinhart and Wickham 1994). This means that when countries become more dependent on oil and mineral exports they also become more vulnerable to economic shocks.

Studies show that revenue shocks tend to promote corruption, weaken state institutions, and create a host of budget and management problems. In theory, governments should be able to buffer their economies against these market shocks by setting up stabilization funds and, perhaps, savings funds. Yet in practice these funds are often poorly managed and wind up doing more harm than good (Ascher 1999; Davis and others 2001). Policymakers should consider better ways for governments to smooth their revenue flows—not, perhaps, through stabilization funds but through other devices, such as long-term contracts and insurance mechanisms. This is a critical area for additional research and policy innovation.

Resource Dependence and Governance
Natural resource dependence also has an impact on governments. A strong and effective government should be able to offset some of the economic and social problems caused by resource dependence. But resource dependence tends to influence governments themselves, making them less able to resolve conflicts and more likely to exacerbate them. This occurs through three mechanisms: corruption, state weakness, and reduced accountability.

Corruption
The first mechanism is government corruption. There is strong evidence that, when a government gets more of its revenue from oil, minerals, and timber, it is more likely to be corrupt. Part of this prob-
lem is due to the sheer volume of resource revenues: governments can absorb, and effectively track, only limited amounts of money. Resource wealth often floods governments with more revenue than they can manage effectively. Another part of the problem comes from the volatility of resource revenues: sudden ebbs and flows of revenues tend to overwhelm normal budgeting procedures and can weaken state institutions.

There are, unfortunately, many examples of resource-linked corruption. In the case of a major oil-exporting African country, almost $1 billion reportedly disappeared from the government’s accounts in 2001 due to corruption. Fiscal discrepancies over the previous several years represented between 2 and 23 percent of the country’s GDP. Most of these losses were linked to the country’s dependence on oil. Large fractions of the signing bonuses for oil contracts disappeared, and the state oil company was criticized for managing the country’s oil receipts through “a web of opaque offshore accounts,” even though local law requires that the funds be handled by the central bank (Cauvin 2002; also see Global Witness 2002).

Weak Government
Natural resource wealth, ironically, can weaken governments—making them less capable of resolving social conflicts and providing public goods like health care and education. This can happen in two ways. One is by weakening the state’s territorial control. If a country has a resource that is highly valuable and can be mined with little training or investment—such as alluvial gemstones and minerals like coltan and tanzanite—it will be difficult for the government to provide law and order in the extractive region. This opens the door for criminal gangs, warlords, and rogue military officers, who may eventually grow strong enough to challenge the government (see Reno 1995, 1998; Ross 2002b).

A second way this occurs is by weakening a state’s bureaucracy. Some scholars have found that, when governments raise their revenues from oil instead of taxes, they fail to develop the type of bureaucracy that can intervene effectively in social conflicts. The result may be a heightened danger of civil war (Beblawi 1987; Fearon and Laitin 2002; Karl 1997; Mahdavy 1970).

Unaccountable Government
The third effect is reduced government accountability. Governments that get their income from natural resources become less democratic—and hence less accountable—than countries that rely on other sources of revenue, such as taxation. One reason for this pattern is that when
governments have an abundance of revenues they tend to use them to quell dissent—both by dispensing patronage and by building up their domestic security forces. Indeed, oil- and mineral-rich governments generally spend unusually large sums on their military forces (Ross 2001a).

A second reason is corruption: instead of serving all citizens equally, corrupt governments tend to favor the wealthy, since the poor cannot afford to pay the necessary bribes. A third way is through the involvement of the military. In some states, resource industries are controlled by the military, giving the military more independence from, and greater influence over, the civilian government. In Indonesia, for example, the military has a large stake in many forest concessions and collects fees from oil, gas, and mineral companies. Since this money goes directly to the military, it does not pass through the central government’s normal budgeting procedures, and the legislature has no influence over how it is spent. The result is that certain resource sales make the military less accountable to the legislature, undermining Indonesia’s fragile democracy.

Once again, the harm that resource dependence does to democracy is intrinsically deplorable, but it also can make states more vulnerable to civil war. Several studies find a link between a government’s accountability and the likelihood that it will suffer from a civil war.

Governments that are less than fully democratic are less able to resolve the grievances of their citizens and hence may be more prone to outbreaks of violent conflict.

It is easy to see how the effects of resource dependence on economies and governments can reinforce one another, creating a trap. Economic stagnation tends to destabilize governments. When governments are unstable, corruption can flourish. Corrupt governments cannot manage their economies well or properly counteract economic stagnation. Many countries have fallen into these kinds of traps; sometimes the outcome is a downward spiral that eventually leads to civil war—for example, in Algeria, the Democratic Republic of Congo, Liberia, and Sierra Leone.

What Can Be Done?

Perhaps the most important international response is to promote revenue transparency, both at the international and domestic levels. MakePaymentsfromTransnationalCompaniesTransparent. Governments misuse the revenues they get from natural resources in part because the quantities are so large, and the government collects them in ways that are difficult for their citizens to track. Many of these funds wind up in off-budget accounts or the pockets of government of-
ficials and are never heard of again. The Publish What You Pay campaign has called attention to this problem and developed a strategy to persuade companies to disclose fully all payments they make to host governments. Chapter 3 offers a careful and comprehensive assessment of this issue.

Full disclosure of all resource revenues would be a major step toward curtailing corruption in the resource sector. But it is critical that a disclosure regime be comprehensive and mandatory. A partial regime may be worse than none at all: imagine, for example, that responsible companies decide to disclose all payments they make to host governments and, as a result, they are no longer able to work in countries with high levels of corruption. If the responsible companies are then replaced by other firms, which do not comply, the outcome is even worse: irresponsible firms are free to work with unscrupulous governments, and responsible firms are driven out of high-risk countries altogether.

Increase Domestic Financial Transparency. Even if all foreign firms comply with a full disclosure rule, it would not be sufficient to sever the connection between resources and conflict. Determined governments will find ways to circumvent disclosure requirements, for example, by replacing royalty contracts with production-sharing contracts, where disclosures might mean little, or by working with domestic intermediaries instead of foreign companies.

Full *domestic* transparency—an independently audited account of all government revenues, including resource revenues—would place greater pressure on governments to reduce corruption and spend their funds accountably. The World Bank, International Monetary Fund, and World Trade Organization, export credit agencies, and the major bilateral donors may be able to bring about progress in this area, particularly if they work collectively.

Resource Abundance and Secessionist Movements

Resource wealth tends to promote civil wars through a third mechanism, by giving people who live in resource-rich areas an economic incentive to form a separate state.

Table 2.6 lists nine secessionist civil wars.

| Table 2.6 Mineral Resources and Secessionist Movements, 1949–Present |
|-----------------|-----------------|
| **Country**     | **Region**      |
| Angola          |                 |
|                 |                 |
Cabinda
1975–
Oil
Congo, Dem. Rep. of
Katanga/Shaba
1960–65
Copper
Indonesia
West Papua
1969–
Copper, gold
Indonesia
Aceh
1975–
Natural gas
Morocco
West Sahara
1975–88
Phosphates, oil
Myanmar
Hill tribes
1949–
Tin, gems
Nigeria
Biafra
1967–70
Oil
Papua New Guinea
Bougainville
1988–
Copper, gold
Sudan
South
1983–
Oil

28
michael ross
wars in regions that have abundant mineral resources.
10
These resource-
inspired insurrections have several common elements. One is that,
before the resource was exploited, people in these regions had a dis-
tinct identity—whether ethnic, linguistic, or religious—that set them
apart from the majority population.
Another is the widespread belief that the central government was unfairly appropriating the wealth that belonged to them and that they would be richer if they were a separate state. Finally, in most cases, local people bore many of the costs of the extraction process itself—due to land expropriation, environmental damage, and the immigration of labor from other parts of the country. The case of Aceh, Indonesia, offers a good illustration.

In many ways, Aceh—a province on the northern tip of the island of Sumatra—was an unlikely place for a separatist rebellion. Aceh played an important role in throwing off Dutch colonial rule in the 1940s and establishing the Indonesian republic. Although the Acehnese consider themselves ethnically distinct from the rest of Indonesia’s population, they adhere to the same religion (Islam) and generally speak the national language (Bahasa Indonesia). Aceh had one of the highest rates of economic growth of any province in Indonesia in the 1970s and 1980s; by the late 1990s Aceh was at or above the national average in per capita income and in most welfare categories.

Yet a secessionist movement was formed in Aceh in 1976, just as a large natural gas facility was beginning its operations. The facility generated local resentments in at least four ways: the site’s construction displaced hundreds of families and several entire villages; the area’s development created a wave of immigration and subsequently an anti-immigrant backlash; the discharge of chemicals, plus periodic gas leaks, caused health problems among locals; and the influx of revenues, and the large police and military presence, led to exceptionally high levels of corruption. But the most important source of discontent was the belief that the jobs and the revenues from the natural gas plant were not being adequately shared with the people of Aceh. The separatist movement, popularly known as GAM (Gerakan Aceh Merdeka), seized on this issue. GAM propaganda suggested that, if independent, the Acehnese would become wealthy like the citizens of Brunei, the tiny oil-rich sultanate on the island of Borneo. Although small at first, GAM eventually won widespread support among the population, partly due to the brutality and ineptitude of the government’s anti-insurgency campaign.

These essential features—an ethnically distinct population that bears too many of the costs of resource extraction and enjoys too few of the benefits—are repeated in most of the other cases and set the preconditions for a long and bitter civil war.
lying grievance—that resource revenues are not being shared equally—has merit, and addressing it through negotiations can avert conflict. Better transparency may also help.

Preventive Diplomacy. If a conflict can be anticipated, it can be prevented—at least part of the time—with preventive diplomacy. We know enough about resource-inspired secessionist movements to forecast where they are likely to occur. We also know that once they begin they are exceptionally difficult to stop. Preventive diplomacy could make a real difference.

The civil war in Sudan, for example, might have been averted through wise diplomacy at a critical moment. The war began in 1983 when Sudanese President Numeiry took a series of measures that upset the delicate balance between the predominantly Muslim north and the heavily Christian and Animist south. Among these measures was his decision to place newly discovered oil in the country’s south under the jurisdiction of the north and to build an oil refinery in the north instead of the south. The Sudan People’s Liberation Army (SPLA) subsequently complained that the north was stealing the resources of the south, including oil; demanded that work cease on a pipeline to take oil from the south to the refinery in the north; and, in February 1984, attacked an oil exploration base, killing three foreign workers and bringing the project to a halt (Anderson 1999; O’Ballance 2000). Instead of responding to the SPLA’s demands, however, the government waged a campaign of astonishing brutality. To date, the conflict has killed an estimated 2 million people.

Private resource firms can also help to prevent conflict in high-risk regions. A good example is the strategy that BP has adopted in the Indonesian province of West Papua, a resource-rich region with a long-running—and highly popular—separatist movement. BP is now in the midst of exploiting a vast natural gas field off the Papuan coast and building a $2 billion onshore facility. This is precisely the kind of project that is likely to produce new grievances and add fuel to the separatist movement. BP has made an admirable effort, however, to anticipate this danger by engaging in widespread community consultations to minimize the costs placed on local peoples, by promoting community-based programs to help distribute the benefits of development in sensible ways, and by not allowing the Indonesian military to station troops at the facility, so as to avoid the provocations and human rights abuses carried out by the military at some of Indonesia’s other major extraction sites.
**Increase Transparency.** Better transparency in resource revenues might also help to avert these conflicts. Citizens typically have little idea how much money resource projects generate; this makes them susceptible to exaggerated claims that their resources are being “stolen” by the central government. In Aceh, Indonesia, the separatist movement frequently made fanciful claims about the income that was generated by the natural gas facility—for example, that an independent Aceh would have the same per capita income as Brunei.

These fabrications were widely believed because the Indonesian government had long concealed and misused resource revenues, making the Acehnese justifiably suspicious of the government’s assurances. Greater domestic transparency might have prevented the propaganda of a small separatist group from gaining credibility and, ultimately, from triggering a conflict that is now in its third decade.

**Rebel Financing**

There are hundreds, perhaps thousands, of rebel organizations around the world at any given time. Yet only a handful grow large enough to challenge the armed forces of a sovereign government. Why are these groups successful, while most other groups fail? There is good evidence that rebel financing is a large part of the answer. To assemble and sustain a fighting force of hundreds or thousands of soldiers, a rebel group needs a regular source of income.

Before the end of the cold war, successful rebel groups in the developing world typically were financed by one of the great powers. Since the cold war ended, insurgent groups have been forced to find other ways to bankroll themselves; many have turned to the natural resource sector (Keen 1998). In Angola, for example, UNITA (National Union for the Total Independence of Angola) was backed by South Africa and the United States for most of the 1970s and 1980s. But the end of the cold war, and the end of apartheid in South Africa, left UNITA with no outside sponsors. As a consequence, it began to rely much more heavily on diamond revenue to support itself (Le Billon 2001). Similarly, in Cambodia the Khmer Rouge had long been financed by the Chinese government. But at the end of the 1980s the Chinese government curtailed its support, which led the Khmer Rouge to adopt a strategy of selling timber and gemstones to gain funding (Le Billon 2000; Thayer 1991).

Why natural resources? There are probably two reasons: the extraction of natural resources can produce unusually large profits (that
is, rents), and their production is tied to a specific location and cannot be easily moved. These characteristics make natural resource firms—particularly mineral firms—unusually susceptible to looting, or extortion, on a sustained basis. If rebels instead try to loot or extort money from manufacturing firms, the firms either move to a safer area or are forced out of business. But mining firms cannot move, and they often earn enough money to pay off rebel groups and still earn a profit. These characteristics—plus the location of most resource industries in rural areas, remote from government centers—make resources an ideal source of income for rebel groups.

Rebels raise money from resources in three main ways: through the direct looting and sale of resources, through the sale of resource futures, and through extortion and kidnapping.

Direct Resource Looting

Many rebel groups have financed themselves by selling natural resources. In general, these are resources that can be easily exploited by small numbers of workers with little training and little or no investment, such as coltan, gemstones, or timber. Since the late 1980s, there have been seven prominent examples:

- Angola’s UNITA over the course of the 1990s sold hundreds of millions—perhaps even several billion—dollars worth of diamonds (Le Billon 1999).
- Afghanistan’s Northern Alliance in the 1990s financed itself through the sale of $40 million to $60 million of lapis lazuli annually (Rubin 2000).
- A variety of groups in Myanmar, associated with the Kachin, Shan, and Wa peoples, sustained their armies in the 1970s and 1980s by selling jadeite, opium, rubies, sapphires, and timber (Lintner 1999; Smith 1999).
- Cambodia’s Khmer Rouge at its peak in the early 1990s earned between $120 million and $240 million a year from the sale of rubies and timber (Brown and Zasloff 1998; Le Billon 2000).
- A range of armies in the Democratic Republic of Congo—both foreign forces and domestic militias—have systematically looted the country from the beginning of the current conflict, in 1998, to the present; among the looted goods have been coffee, coltan, diamonds, gold, and timber (see UN Panel of Experts 2001).
- In the early 1990s in Liberia, Charles Taylor’s National Patriotic Front of Liberia was thought to be earning some $75 million a year from taxing the sale of cannabis, diamonds, iron ore, rubber, and timber (Ellis 1999).
In Sierra Leone in the mid-to-late 1990s the Revolutionary United Front (RUF) sustained itself largely by producing between $25 million and $125 million in diamonds a year (UN Panel of Experts 2000).

Sale of Future Rights to War Booty

A less common—but possibly more dangerous—type of resource transaction is the sale of future exploitation rights to the spoils of war. The seven examples in the previous subsection cover the sale of resources already captured by the rebels. However, sometimes combatants sell exploitation rights to natural resources that they do not yet control, but that they hope to capture in battle. Since these transactions are for the sale of future exploitation rights, they might be called “booty futures.” They are similar to other types of commodity futures. But while normal markets for commodity futures—like the Chicago Board of Trade—are formal, regulated, centralized at a single location, and have many buyers and sellers, the wartime market for booty futures is informal and often covert, has no fixed location, and includes a relatively small number of actors. It operates only in Africa, at least so far. The booty futures market can help to solve the financing problems that prospective rebel movements often face, provided they wish to do battle in a resource-rich country. If an aspiring rebel group has no money, but stands a chance of capturing valuable resources in combat, it can sell off the future right to exploit the resources it hopes to capture, either to a foreign firm or to a neighboring government. The rebels can then use this money to pay soldiers and buy arms and thus gain the capacity to capture the promised resource.

The market for booty futures is in some ways more dangerous than the standard market for conflict diamonds and other wartime commodities, since the booty futures market tends to benefit the weakest combatants. When combatants in a civil war sell natural resources that are under their control, this indicates that they are in a relatively strong military position, since they control a valuable piece of territory. But if they must sell resource futures, this implies that they are in a weak position, since they have not yet captured the resource whose value they hope to exploit.

The sale of booty futures is a tool of the weak against the strong: it helps to fund groups that are too poor or too feeble to capture territory on their own and might otherwise be forced to surrender. It hence tends to fund the initiation of civil wars that might otherwise never begin or to lengthen wars that are on the verge of ending. The sale of booty futures is also dangerous because it has self-fulfilling properties. If the rebel group is unable to sell the future right to exploit the
resource, it might not have the funds it needs to capture the resource itself. Selling the future right to the resource makes its seizure possible. Without the futures market, the rebel offensive—and perhaps the conflict itself—would be less likely.

Not only can the trade in booty futures help to initiate conflicts, it also can lengthen preexisting conflicts. If either side in a civil war is near defeat, and is fighting for control of resource-rich territory, it can try to sell off the future right to exploit the resources it hopes to capture or retain on the battlefield. Again, the sale of booty futures can have self-fulfilling properties: the sale of future rights enables the army to capture or hold the resource itself. Instead of being defeated or forced to the negotiating table, the army is able to continue fighting—thus lengthening the war.

In the 1997 civil war in Congo-Brazzaville, the private militia of former president Denis Sassou-Nguesso was funded, in part, by the sale of future exploitation rights to the Congo’s extensive oil reserves. On the eve of the conflict, Sassou received substantial assistance from a European oil company. Some reports suggest that he received $150 million in cash; others state that the company helped him to purchase arms (see “Angola Aids Congo” 1997; Galloy and Gruénai 1997). These funds enabled him to defeat the incumbent president, Pascal Lissouba, following a four-month war that destroyed much of Brazzaville and cost 10,000 lives. These booty future swaps—and similar trades in Angola, the Democratic Republic of Congo, Liberia, and Sierra Leone—in each case have helped to initiate a war or prolong one that appeared to be ending (see Ross 2002a).

Extortion and Kidnapping

Under certain circumstances, rebels can earn large sums by extorting money from, and kidnapping the workers of, resource firms. Although extortion and kidnapping are endemic in conflict zones, a major resource industry can make these activities more profitable.

Extortion and kidnapping have been important features of the Colombian civil war, and they also played smaller roles in the wars in Aceh, Indonesia, and in Sudan. In Colombia and Sudan, the targeted resource was oil—or, rather, a long oil pipeline that ran through contested territory. In Aceh, it was a natural gas facility. In Colombia, oil must be transported to the coast from the unstable interior through pipelines that are hundreds of miles long. In 2000 the pipelines were bombed 98 times. Colombia’s rebel groups have used these attacks to extort an estimated $140 million annually; this windfall has enabled one group, the National Liberation Army (ELN), to grow from fewer than 40 members to at least 3,000 (Dunning and Wirpsa 2002). Colombia’s rebel
groups have also turned kidnapping into a major industry. According to a government study, between 1991 and 1999 they earned a remarkable $1.5 billion from kidnap ransoms; many victims were associated with the oil industry (Pax Christi Netherlands 2001).

What Can Be Done?
Three initiatives could help to curtail the use of resources to finance rebel armies: a regime to control the flow of conflict commodities, a ban on resource futures, and restrictions on ransom payments. 

Control Illicit Resource Flows. A major effort to restrict the trade in “conflict diamonds” was launched in May 2000, at a conference in Kimberley, South Africa. The Kimberley Certification Process Scheme entails an agreement by the diamond industry to trade only diamonds that can be certified as originating from legitimate sources. Even if it works as planned, the Kimberley process addresses only one of several conflict commodities. Other types of precious stones—jadeite, lapis lazuli, rubies, and sapphires—have also been used to finance recent conflicts. So have coltan and timber. All of these resources are highly “lootable”—that is, they can be extracted by unskilled workers and have high value-to-weight ratios. A comprehensive regime to ban the trade of all conflict commodities would have to address these goods as well. Although the trade in conflict commodities may never be eliminated, their price can be reduced considerably—thereby reducing the flow of funds to rebel groups. 

Ban Booty Futures. The United Nations Security Council has taken measures against the sale of natural resources by rebel forces in Angola, the Democratic Republic of Congo, Liberia, and Sierra Leone. But the booty futures market creates problems that cannot be solved by ad hoc, country-specific sanctions. Sometimes the sanctions come too late: the sale of booty futures can help to initiate a civil war, while the Security Council typically intervenes only after wars have been going on for months or years. The sanctions may also be directed against the wrong party: they typically apply to rebel groups, not governments—but in Angola, Republic of Congo, the Democratic Republic of Congo,
and Sierra Leone, the government at least attempted to tap the booty futures market when rebels were approaching victory. A blanket prohibition on the sale of future rights to war booty—and strict sanctions against any commodity sold through such a contract—would be far more effective.

Restrict Ransom Payments. Anytime a ransom is paid to a kidnapper, it produces obvious short-term benefits but much larger, hidden, long-term costs. The obvious benefit is the release of the kidnap victim; the hidden cost is the encouragement it gives to all organizations that specialize in kidnapping, now and in the future. Kidnapping is like any other type of business: if it is sufficiently profitable, old kidnapping organizations will expand and new kidnapping organizations will arise. In some countries, such as Colombia and the Philippines, the kidnapping industry has grown to an alarming size. To take away the incentive that groups have to kidnap workers in the resource industry, there should be international restrictions on ransom payments. These should include prohibitions on the sale of insurance against kidnapping, which tends to make ransom payments swifter and easier and may reduce the incentives for potential victims to take precautions.

Conclusion

This chapter reviews what scholars have learned about the role that resources play in conflict. It suggests that resource dependence can promote civil war through four types of effects: by harming a country’s economic performance; by making its government weaker, more corrupt, and less accountable; by giving people who live in resource-rich regions an incentive to form an independent state; and by helping to finance rebel movements.

It also discusses a series of measures that could help to stop these patterns—measures that include removing OECD trade restrictions, reducing the volatility of resource revenues, increasing the transparency of resource payments to governments, undertaking preventive diplomacy, restricting the trade of conflict commodities, banning the sale of future rights to war booty, and restricting the payment of ransom to kidnappers. These measures are discussed in a preliminary manner to stimulate further debate and study.

Many of the countries suffering from resource-based conflicts are stuck in low-level development traps. In these countries—most of them in Africa—poverty, weak and corrupt government, and violent conflict reinforce one another. Left to their own devices, these countries will generate extraordinary hardships for their own citizens and, ultimately, for the international community. Strong measures, like the ones dis-
cussed here, can help them to break out of this trap. Many of the policies discussed here can work only if they are enacted at a global level. Issues such as trade barriers, transparency, and the monitoring of conflict commodities can be addressed only through comprehensive, multilateral agreements. In some cases, partial or voluntary measures may do no good at all or even make things worse. For example, if some oil companies publish what they pay and others do not, we may find the most transparent and responsible companies driven out of corrupt, high-risk environments and less responsible firms moving in. If some firms try to behave ethically by refusing to pay kidnap ransoms, while others continue to pay them, employees of the ethical firms will be penalized, and the net effect on the kidnapping rate will probably be negligible. In both examples, ethical behavior is penalized and the underlying problems remain unsolved.

As difficult as stopping civil wars may be, it has grown easier in the last 10 years. The funding that natural resources provide to governments and rebels locked in combat can be stopped; the funding that the great powers once provided to combatants could not. A decade ago, before there was much of an Internet, financial transparency was a weak tool; now it is a strong one. The international policy community has a unique opportunity—and hence, a unique responsibility—to take action.

Notes
1. Important studies that touch on the role of natural resources in civil wars include Buhaug and Gates (2002); Collier and Hoeffler (1998, 2001); De Soysa (2002); Doyle and Sambanis (2000); Elbadawi and Sambanis (2002); Fearon (2002); Fearon and Laitin (2002); Hegre (2002); Keen (1998); Reynal-Querol (2002); Ross (2002a, 2002b).
3. This study looks only at nonfuel minerals—that is, not oil or natural gas.
4. Minerals and oil dependence was measured as the ratio of exports to GDP.
5. Resource dependence may also produce “Dutch disease” effects, but it is not evident that these make states more susceptible to civil war.
6. The nationalization of foreign oil and minerals firms in the 1950s, 1960s, and 1970s has also made states more vulnerable to economic shocks. Before nationalization, foreign corporations often captured and repatriated a large fraction of any resource rents, including those created by resource shocks. This drain of wealth was much resented by developing-state governments. Yet, ironically, the repatriation of resource windfalls provided these governments with the unintended benefit of insulating state institutions from the volatility...
of international commodity markets. By expropriating foreign corporations—at a time when resource prices were growing even more variable—resource-exporting governments unwittingly exposed themselves to large market shocks. 

7. Gelb and Associates (1988), for example, find that the oil booms of the 1970s generally were associated with a sharp drop in the efficiency of public investments, which indicates that corruption levels were rising. Similarly, Collier and Gunning (1999) find that commodity booms in developing states, for a wide range of products, were associated with a subsequent fall in investment efficiency. Ross’s (2001c) study of the Indonesian, Malaysian, and Philippine timber sectors reports that rising timber prices led to heightened levels of corruption and the dismantling of institutions that had earlier protected the forest sector from misuse. Marshall (2001) reports evidence of unusually high rates of corruption in the minerals sector of many countries. Several statistical studies find the same pattern. Sachs and Warner (1999) find a strong correlation between resource dependence and a widely used measure of corruption; Gylfason (2001) and Leite and Weidmann (1999) produce similar results.


9. Important analyses of this problem include Collier and Hoeffler (2002); Fearon (2002); Le Billon (2001).

10. Since any region might be perceived as having some type of resource, I have limited this list to regions with significant oil or mineral industries in operation, or under development, at or near the time when the civil war began. Examples can also be found in wealthy states: Collier and Hoeffler (2002) describe the case of Scotland, where a peaceful independence movement emerged in the early 1970s following a sharp rise in the value of North Sea oil.

11. This account is based on Ross (2002d).

12. According to Fearon (2002), separatist insurgencies over natural resources tend to last longer than any other type of civil war.

13. This claim was exaggerated by more than an order of magnitude, even under the most generous assumptions; see Ross (2002d).

14. This argument is developed by Collier and Hoeffler (2001).


16. The sale of booty futures is not an entirely new phenomenon. In 1960 the Katanga rebellion in the Democratic Republic of Congo, led by Moïse Tshombe, was bankrolled by a European mining firm; in exchange, the firm apparently sought future mineral rights. See Gibbs (1991). During Algeria’s war of independence, a European oil company reportedly supplied money and arms to the National Liberation Front (FLN) in exchange for future “considerations.” See Le Billon (2002).

17. Kidnappings are often carried out by other types of criminal organiza-
tions as well, including paramilitary groups and rogue police units.
18. For an excellent account of the Kimberley process, see chapter 6.

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Michael Ross
This chapter looks at the reporting of resource revenues that host governments receive. Reporting as used here includes formal reporting of revenues to a particular body, audits and reconciliation procedures, as well as requirements to make information on such revenues publicly available (although information reported to a government body or other party is not always made public). Almost by definition, reporting concerns commodities that are legally traded. Here we focus on the oil and minerals sectors, while diamonds, timber, and several other commodities are covered to a lesser extent. Reporting is a means to achieve transparency, which itself is a precondition for curbing corruption, mismanagement, and diversion of funds. The assumption is that strong reporting practices should increase transparency and oversight of financial flows, which in turn should reduce the possibilities and temptations for misappropriation. It is also assumed that strong reporting practices and transparency could provide host-country publics with an important part of the information they need to monitor the way their government uses the revenues it accrues. However, public knowledge of the full amount of revenue available to the government (or its elites) will not, on its own, pressure a government to make better spending choices; information on spending and probably a minimum of organized political opposition must also be available for this to happen. Nevertheless, public knowledge of potential income should make it more difficult for elites to divert large amounts of such revenue from the central budget, meaning that, in theory, more could be available across-the-board for public programs such as health and education. A major problem is that host governments often have incentives not to reveal the extent of their resource revenues. Moreover, the
leverage of the international community in this regard is probably limited. This is because large resource revenues usually give host governments the ability to reject assistance attached to conditions they do not like. If the host government is not providing information about the resource-related revenues available to it, an important indirect way of viewing these flows is to look at the payments that resource extraction companies make to the government. For this reason, non-governmental organizations and others focus primarily on company reporting.

The first section explores what is known about the reporting systems of governments in developing countries. The second section briefly covers what is known about how oil companies report the payments they make to host governments. It draws primarily on work by Global Witness and the Publish What You Pay campaign. The third section reviews several additional issues related to host-government reporting: in particular, whether states tend to report resource revenues more accurately when they are treated as general revenues or when they are placed in a separate fund; whether some particular government functions are associated with poor reporting (with a focus on the role of resource parastatals); whether the quality of revenue reporting is influenced by revenue volatility; whether the quality of reporting varies by type of resource; and the effect of having a country’s military forces directly accrue resource revenues. The fourth section looks at recent international initiatives that could be relevant for increasing the transparency of resource revenue flows. The initiatives covered are divided between those relevant primarily for host-government reporting and those relevant primarily for company reporting, although there could be overlap in some cases. The last section offers policy recommendations for global action.

Reporting Resource Revenues

This section examines what is known about how the flows of natural resource revenues are reported. It focuses on reporting by host governments. However, it also looks at reporting by extraction companies as an indirect way of estimating revenues received by host governments.

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Reporting by Host Governments

Host countries receive revenue from resource extraction and exports in a number of ways. The most important of these usually are payments by private extraction companies, including taxes, royalties, and one-off or periodic payments, such as licensing or concession fees, signature bonuses, and other bonuses related to a particular stage in a project. The following are examples of payments that international companies
make to host governments in the oil and gas sectors:
• Payments to central and federal governments, such as ministries of finance, the revenue authority, and the central bank, including taxes, royalties, dividends, signature bonuses, and profit share
• Payments to regional and local governments, including development funds and regional taxes
• Payments to other government agencies, including customs duties, fines (for example, to environmental agencies for spills and emissions), costs for studies (payable to government institutes or laboratories), and port fees
• Payments to state companies, including tariffs to pipeline monopolies; payments to utilities, railway, and air transport state monopolies; and drilling contracts
• Payments in kind (barrels of oil equivalent) for royalty, profit, and equity share
• Payments for the acquisition of shares in state companies, for example, through government privatization, including the purchase of bonds issued by state companies
• Payments related to joint ventures with state oil companies, including profit and dividend payments to the state company (including money remitted from ventures executed in other countries) and contributions for capital expenditures.
Other revenue flows can be provided via state-owned resource extraction companies, which may be partners in joint ventures with foreign firms, especially in the oil and mining sectors. Joint venture projects can imply income for the government that is not derived from payments by private or foreign companies.

Reporting Procedures in OECD Countries. Revenue reporting procedures are generally well documented and transparent in countries of the Organisation for Economic Co-operation and Development (OECD). For example, a recent, publicly available review by the United Kingdom’s National Audit Office notes, “There are clear reporting lines through which the U.K. Oil Taxation Office provides Inland Revenue senior management with regular accounts of progress against targets”
p. 17). U.S. and Norwegian procedures are similarly well documented and transparent.

The OECD notes that, in its member countries, “the fiscal practices that promote integrity and accountability have been the subject of considerable discussion in recent years and there has been much progress in defining appropriate practices.” Examples include the OECD’s Best Practices for Budget Transparency and the IMF’s (International Monetary Fund’s) Code of Good Practice on Fiscal Transparency. However, the OECD notes, “In troubled countries, fiscal frameworks may not incorporate even the most rudimentary principles for effective public management for both revenues and expenditures” (OECD 2002b, p. 15).

Reporting Procedures in Developing Countries. In general, little public information is available about the way in which developing-country host governments report revenue from their extraction and export of resources. Furthermore, the collection and reporting of resource revenue in such countries are poorly covered in the academic literature. Based on what has been written, however, reporting procedures, where they exist, often are rudimentary, perhaps deliberately so. In some cases, this may be due to lack of knowledge about best practice, but in others it may be part of a general tactic to avoid accountability. The observations of Ascher (1999) for the logging sector also probably apply to revenue reporting in most high-rent natural resource sectors in developing countries: “Apparently weak enforcement capacity’ is as much a choice as a ‘given,’ and lack of enforcement capacity is often part of the strategy of resource maneuvers.” Moreover, governments have reduced the public awareness of such maneuvers “by suppressing information, as in the minimal reporting requirements for timber companies in Indonesia, or by making financial transactions and accounting so opaque that monitoring becomes virtually impossible, as in the case of the Nigerian and Mexican oil companies” (Ascher 1999, p. 259).

Unfortunately, Ascher and other authors we have reviewed do not provide specific examples of these minimal procedures, where they exist. Nordoesthe lite re covering resource exploitation and revenue who gets the money?

flows describe the procedures for reporting. Most research in this area focuses on the macroeconomic and corruption effects that large rents can have on the developing-country host government and, related to this, on how revenues are spent. The literature on logging, for example, focuses on the failures of forestry policy that have led to illegal logging or allowed logging concessions to be underpriced. The literature on diamonds focuses on the trade in conflict diamonds, which usually are diamonds that have been mined and traded outside host-government
official control. Other sources of information also have limitations. For example, international oil and mining companies presumably are in a better position than most to know about the internal reporting procedures of host governments. However, discussions with a number of company representatives shed little light on the issue and left us with the impression that companies have little incentive to find out—or admit to knowing about—the internal procedures followed by host governments once companies have made their payments.

1 Information obtained via cooperation between developing-country host governments and international financial institutions probably has been limited by the fact that large resource revenues usually have given countries the ability to avoid cooperation that could impose difficult conditions, for example, examination of their revenue-reporting procedures.

Public expenditures reviews and other economic and sector work carried out by the World Bank provide overviews of controls in some developing countries. However, such work generally has not been performed in resource-rich countries. According to the IMF and World Bank websites, within the last five years such reviews were rarely conducted for countries that Global Witness lists as having resource-related governance problems. Nevertheless, there are notable exceptions, such as the public expenditures review for Kazakhstan, completed in 2000–01; assistance given to Azerbaijan’s Oil Fund; and involvement in creating procedures for reporting oil revenue for Chad as part of the Chad-Cameroon Petroleum Development and Pipeline Project.

2 A handful of other public and private studies and international development projects have provided glimpses into the reporting structures of a number of other countries, although this has not been an important focus of such studies. Such glimpses reveal procedures that often are rudimentary.

Most of the systems about which we have significant knowledge are those that have been imposed relatively recently by the international community on governments still in the early or expectant stages of resource revenue wealth—that is, on governments not yet in a position to refuse aid conditionality. Such procedures have not yet been adequately tested in practice.

Reporting by Companies
If the host government does not provide information about its resource revenues, an indirect way of viewing these flows is to look at the pay-
ments that resource extraction companies make to the government. In theory, disaggregated records of payments by companies to individual governments could be reaggregated to provide an overview of the amount of money being made available. In practice, this is difficult for several reasons.

The existence of collective action problems among companies means that, in practice, host governments can put a great deal of pressure on companies (especially in the oil industry) not to reveal such information, often citing “commercial confidentiality” agreements. In the face of host-government opposition, companies are not inclined to reveal information that may cause them to lose government favor and thus their comparative advantage with respect to rival firms.

In addition, as many international oil companies have pointed out, transparency of payments by international companies would provide only part of the picture. It would not necessarily cover the often-significant revenue flows through government-owned extraction companies. This is especially the case with joint ventures where the government-owned extraction company is not paid directly by the foreign company but receives a share of the resources or revenue of the joint venture. In practice, most companies report only what is required by regulators in their host and home countries.

Confidentiality Provisions in Contracts. Many companies in the oil sector have signed contracts with developing-country host governments or state oil company partners that have confidentiality clauses. Such clauses often include requirements not to reveal tax and other payments that have been made to the host government.

A survey of four OECD jurisdictions (Alaska, Alberta, Norway, and the United Kingdom) and three non-OECD jurisdictions (Angola, Myanmar, and Nigeria) finds that OECD countries do not prohibit the disclosure of payments to the host government; this occurs only in non-OECD countries. According to OECD (2002b, p. 18), “This suggests that there are ways of protecting the legitimate interests of both business and governments while not compromising revenue transparency and accountability.”

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Global Witness has urged companies to form a common approach to ensure that confidentiality clauses address legitimate commercial concerns only and do not cover basic payments to the state. The elimination of nondisclosure clauses would make it more difficult for companies to justify not publishing the amounts they pay to host governments. However, it may not be enough to counter the apparently strong incentives some host governments have for keeping payments secret and for putting pressure on companies to do so. BP reportedly
came under very strong pressure from the Angolan government even though the information on payments it released in early 2001 apparently did not fall under its confidentiality clauses.

Confidentiality clauses also exist in the mining sector, although this industry appears to be making relatively more progress than the oil sector in dealing with the issue. For example, mining groups under the Mining, Minerals, and Sustainable Development (MMSD) Project have worked with Transparency International to increase the transparency of agreements between mining companies and governments, and MMSD has discussed creating an international database of members’ payments (MMSD 2001).

Reporting to Host Governments. Companies in most extractive industries usually are required to report some information to the host government in order to allow it to calculate taxes due. Although the information required varies by industry and country, it generally includes information on production, sales, costs, and profits. However, host governments in developing countries rarely make such information publicly available.

There are a number of commercially available sources of information on fiscal arrangements in the oil, gas, and mining sectors of various countries, including developing countries, where much of the world’s resource extraction activity takes place.

Such sources often specify the basis on which tax and other payments are calculated, but not the reports that must be filed. Moreover, they rarely provide information on the negotiated terms of a particular production-sharing agreement. Nevertheless, information on supposedly secret contracts often can be obtained through private consultancies.

Government websites in OECD countries, such as the website of the U.S. Mineral Revenue Management Service, often list reporting requirements for companies, including downloadable versions of forms that must be filed.

Examples of this practice are rare in developing countries.

Some countries (mostly in the OECD) require companies to file financial information on a regular basis with an official government information register, for example, the Registrar of Companies in the United Kingdom or the Brønnøysund Register Centre in Norway. Such information is used by government bodies and is often accessible by
Although most are in OECD countries, several are in developing countries, including a few countries identified as having difficulty tracking resource revenues. Moreover, although reporting requirements for many OECD countries include company annual returns and tax payments, public reporting procedures in most non-OECD registers are limited to company contact details and other basic, nonfinancial information.

Reporting to Home Governments. In its report All the Presidents’ Men, Global Witness provides a brief overview of reporting requirements in the United Kingdom and United States for the overseas operations of companies registered in those countries (Global Witness 2002). The United Kingdom only requires each company to provide the total amount of “overseas taxation” paid, which is not broken down by country. In cases where the company has set up subsidiary oil companies for operations in a particular country, payments to that country can be calculated as long as all subsidiaries for the particular country are accounted for. However, not all companies operating in the same country will necessarily operate via separately listed subsidiaries. In Norway requirements are similar to those in the United Kingdom. In the United States, the Securities and Exchange Commission requires its listed companies to keep track of payments by foreign companies for its internal records and for inspection by U.S. regulators but does not require such records to be published or otherwise made publicly available.

The main initiative in the area of company reporting of revenue payments is the Publish What You Pay campaign, which is spearheaded by the nongovernmental organization Global Witness and by George Soros. In recognition of the collective action problems faced by the oil companies, the Publish What You Pay campaign is calling on home-country governments to require “their” companies to reveal payments. The suggested mechanism is for developed-country governments to require their stock exchanges to demand regular issuance of such information as a condition for listing.

According to Global Witness, the Publish What You Pay campaign has focused on the vehicle of stock market listings because many confidentiality agreements reportedly have an opt-out clause if information is required by regulators. For example, according to Publish What
approval, disclose such information to the extent required by any applicable law, regulation, or rule (including, without limitation, any regulation or rule of any regulatory agency, securities commission, or securities exchange on which the securities of such Party or any of such Party’s affiliates are listed).”

As long as all major stock exchanges were involved, it would be difficult for companies to change jurisdictions; otherwise, there would be a risk of transferring the collective action problem from companies to stock markets. However, switching stock exchanges to avoid reporting conceivably could reflect badly on companies worried about their image of corporate social responsibility.

The main criticism of the stock market tactic is that it may not affect the handful of relatively technically advanced state-owned companies operating internationally but headquartered in developing countries. At a minimum, however, it could hinder their ability to raise capital in important Western markets. Global Witness argues that the problem of firms without public listings is likely to be minor and could be addressed as it arises.

The Publish What You Pay campaign appears to be gaining momentum. Although not everyone has endorsed the stock market regulation approach, support is at least growing for the general idea of more transparent company reporting, and such momentum could stimulate other creative tactical options.

Additional Issues Related to Government Reporting
This section examines a number of potentially important issues and their possible impact on the quality of government reporting of natural resource revenue flows, including general revenues versus off-budget funds; particular government functions, including the impact of resource parastatals; revenue volatility; and variation in reporting quality by resource type.

General Funds Versus Off-Budget Accounts
Off-budget accounting is fairly common in developing countries, but “what distinguishes economies with high resource endowments from those not having such wealth is the large volume of fiscal flows that are sent through these channels” (OECD 2002b, p. 18). Logically, controls on off-budget accounts are likely to be weaker than controls on central budgets simply because it is easier to keep track of one account than many. Moreover, as case studies in the forestry sector indicate, resource revenue “maneuvers” often are carried out off-budget precisely to decrease the chance of detection (Ascher 1999). Available evidence also indicates that off-budget flows lack trans-
For example, several African case studies performed by the International Budget Project conclude that off-budget revenue flows in Nigeria are significant but that, due to inadequate accountability for such funds, no systematic information is available on their magnitude or on their intended or actual use.

Moreover, many off-budget funds cannot be audited because they fall outside the mandate of the Auditor General. According to Fölscher (2001), no known rules govern deposits into and withdrawals from various accounts and funds. Similarly, more than two-thirds of expenditures in Angola take place outside the formal budgetary system, making their composition difficult to determine (IMF 1997).

At the same time, the regular budgets in many resource-rich developing countries also lack transparency. For example, the International Budget Project report finds no law specifying the format of Nigeria’s central budget, the documents that need to accompany the budget, or how and when budget information is to be disseminated. Moreover, the legal framework does not provide for public participation in the budget process and does not support transparency and accountability (Fölscher 2001).

Ascher, who compiled a number of case studies on natural resource policy failures covering a wide variety of resources and countries, concludes that revenue flows through the central budget are likely to be more transparent than off-budget flows. He points out that, while we have “no way of knowing, a priori, whether the scoundrels who wish to manipulate off-budget slush funds are better or worse than the scoundrels who wish to manipulate the central budget for objectionable ends . . . the latter type of scoundrel is more likely to be taken to task for his or her sins” (Ascher 1999, p. 255).

Resource revenues can enter off-budget accounts via state-owned extraction companies as well as through private firms. However, foreign resource extraction firms cannot always be sure that the accounts into which they pay their taxes flow to the general budget or remain outside the budget. For example, a mining company in Central Asia, following instructions from the Minister of Finance, reportedly paid funds into a particular bank account only to discover that this was a private account owned by the country’s president (MMSD 2001).

Large and nontransparent off-budget flows are tempting targets for embezzlement. Given the high correlation between resource wealth and internal violence (chapter 1), it is not surprising that another major destination of off-budget resource flows is the military. Moreover, off-budget funds may be used to finance developmental or prestige projects...
of questionable economic or social value that may not be expected to stand up to the relatively greater scrutiny of the central budget process.

Trust Funds. Foreign banks sometimes set up off-budget trust funds to help repay loans using future oil or other commodity revenues as collateral. Reportedly, a significant portion of the money from oil sales by the Angolan state oil company, Sonangol, goes directly into these trusts without passing through the central budget. The banks, understandably, have demanded such arrangements as security for their loans. However, the government provides little public information about the flows through such funds. Since such a large portion of Angola’s annual income apparently passes through them, Global Witness has called on banks to publish details so that there can be some outside scrutiny of the amounts involved (Global Witness 2002).

Resource Stabilization and Savings Funds. A number of resource-rich countries have created special funds to receive a portion of natural resource windfalls. Such funds usually are intended to promote macroeconomic stability or to save part of the windfall for the future. Most funds have been set up for oil, but at least one has been related to minerals—Chile’s copper fund—and a number of relatively minor funds have been related to agriculture, such as Colombia’s coffee fund. In general, resource funds have received mixed reviews on macroeconomic grounds and in terms of promoting transparency. For example, according to Davis and others (2001a), governance, transparency, and accountability may well be undermined by an oil fund. By their very nature, oil funds are usually outside existing budget systems and are often accountable to only a few political appointees. This makes such funds especially susceptible to abuse and political interference. Reporting and auditing requirements for the funds are often loose, and their lack of integration with the budget makes it more difficult for both Parliament and the public to monitor the use of public resources as a whole.

Many funds claim to take the Norwegian State Petroleum Fund as an example, while ignoring the important fact that the fund functions as a government account under the control of the Ministry of Finance. Davis and others (2001a) attribute the success of the State Petroleum
countries with a strong commitment to fiscal discipline and sound macroeconomic management. Thus both the studies by Davis and others (2001a) and by Fasano (2000) emphasize the importance of concentrating on fiscal discipline and avoiding the “distraction” of potentially problematic funds.

Caspian Revenue Watch takes a slightly different approach; it assumes that, in some countries at least, it probably will be easier for civil society watchdogs and others to monitor revenue flowing into a specific fund than to monitor revenue going into the general budget.

Government Functions
A number of different actors can be involved in the control and reporting of revenues derived from natural resource extraction. The main ones usually are the Ministry of Finance, the relevant sector ministry, and often a parastatal extraction company. Others include the Office of the President or other powerful politicians or committees that have control over revenue flows.

Typically, the larger the rents involved in the resource, the more the various government actors may try to gain control of their collection and distribution. Rent seeking on the part of individuals or companies wishing to acquire logging concessions, for example, usually leads to what Ross (2001) calls “rent seizing” on the part of officials—that is, attempts to appropriate the right to allocate the economic rents to various private and public interest groups in return for political or other favors. In this way, politicians try to maximize the value of their allocation rights by making them as direct, exclusive, and discretionary as possible. The organization that distributes the extraction rights may not always be the one through which the resulting resource revenues flow.

Available evidence is probably not sufficient to allow generalizations about whether particular state actors are better at reporting resource revenues than others, although reporting is likely to be worse the farther one gets from the Ministry of Finance. Many of Ascher’s case studies in minerals, oil, and timber involve efforts by the technocratic experts of the Ministry of Finance to rein in the resource flows who get the money?

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of line ministries and parastatals that, in turn, try to obscure such flows for their own organizational or personal ends. Such off-budget organizations often depend on the protection of powerful politicians, who also may benefit from the resource revenues. For example, former Indonesian president Suharto reportedly used off-budget funds generated by the state oil company, Pertamina, and later by the Forestry Ministry’s reforestation tax to fund questionable prestige and development projects.
The Finance Ministry was able to rein in Pertamina and redirect its revenue flows through the treasury only after 1979, following Pertamina’s bankruptcy due to uncontrolled overborrowing on international markets (Ascher 1999). The use of state enterprises in the extractive sectors appears to pose particular problems for the transparency of natural resource revenues. With respect to the oil sector in OECD countries, state-owned enterprises enlarge the scope for nontransparency of public accounts (OECD 2002b). In non-OECD countries, where overall fiscal controls generally are less transparent, the potential for opacity of revenue transfers is likely to be greater.

A potential problem is that parastatal companies typically are not integrated into the government in the same way as a line ministry and thus are not likely to come under the same general reporting procedures and controls. An additional problem is that extractive parastatals are likely to operate in remote areas, which poses difficulties for auditing and control. Related to this, at least for mining and oil and gas operations, the technical nature of parastatal activities can make it difficult for government auditors to calculate real costs and profits accurately. For example, after the Pinochet government regained control of the copper industry in Chile, it took the government several years to understand the industry and its accounts well enough to reestablish significant revenue flows through the central budget (Ascher 1999). The government eventually put severe limits on the copper company’s activities, including its ability to invest, in order to “keep the scope of Codelco operations within the capacity of the government to monitor and control.” Noting other examples, such as the oil industries of Mexico, Peru, and Venezuela, Ascher (1999) comments that it is common for state enterprises to be transformed from accomplices in off-budget financing to undercapitalized victims of the efforts of budget authorities to tax and control.

One reason it may be difficult for central budget authorities to keep adequate control over the finances of state-owned oil companies is that the market does not require these companies to provide transparent information. For this reason, state enterprises operate more transparently when they are involved in joint ventures with international companies than when they operate alone, largely because such relationships require more rigorous accounting procedures (Ascher 1999).
create incentives to waste. This is because resource rents can be expected to fall again in the future, and politicians and other parties may wish to take as much advantage as possible from a temporary windfall. Moreover, as Ross (2001) points out, the security in office of politicians overseeing the distribution of resource rents may have an important impact, with less secure officeholders having a greater incentive to divert more revenues to themselves while they remain in power, because they may not be around for the next windfall.

Ross bases his observations on the timber industry, particularly in the Philippines, the Malaysian states of Sabah and Sarawak, and Indonesia. Although volatility of commodity prices and revenue is similar in the mining, oil, and timber sectors, the same forces may not be at work. Given the scale of the initial investments involved, the mining and oil sectors are forced to take a longer-term approach than the timber sector. Nevertheless, because of the exceedingly high rents involved, oil and mineral commodity booms may create incentives for governments to decrease the transparency of revenue flows. However, it is not clear in the case of minerals and oil that the problem is volatility as much as it is simply high rents. In general, mineral- and oil-dependent countries go through a cycle of increased incentives against transparency in times of commodity boom, followed by a period of efforts to rein in spending and control over revenues when commodity prices fall (Karl 1997). In the case of diamonds, the stabilizing role De Beers traditionally plays as the buyer of last resort may make revenue volatility less of an issue.

Another aspect of this problem relates to the so-called “Dutch disease.” A number of countries have set up stabilization funds to deal with the volatile nature of revenue from particular natural resources. However, the use of stabilization funds can add to a country’s fiscal management problems if not accompanied by sound fiscal practice.

Variation in Quality of Reporting by Type of Resource
Although there have been studies on the impacts of different commodities on issues such as the incidence of civil war, there does not seem to have been a study yet comparing the quality of reporting in the various resource sectors. Yet the issues surrounding reporting may be somewhat different in different sectors. In the forestry sector, tax rates often are set too low, not enforced, or not collected due to illegal logging. The diamond sector has experienced similar problems, with small, private sector operators not re-
porting their revenues. Moreover, in both sectors extraction often takes place in remote regions where government authorities have limited control, further compounding the lack of transparency. In both sectors, leakage of revenues before the money reaches a state agent may be a bigger problem than leakage after it has been collected. Also, because these industries tend to be dominated by the private sector, often by small operators, they tend to be less likely than the oil and gas sectors to face the reporting problems related to state-owned companies.

Because it is more difficult to engage in illegal or unmonitored extraction in the technically more complex metals mining and oil sectors, there is generally less scope for revenue leakage before reaching the state. However, the monitoring abilities of state auditors can be an issue. Moreover, these industries are more likely to have to deal with the potential reporting difficulties involved with state-owned companies.

Accrual of Resource Revenues by the Military
There are a number of cases in which a host country’s military has directly accrued resource revenues outside the central budget process. This has involved the mining and oil sectors in Chile and Indonesia as well as timber concessions in a number of Southeast Asian countries.

The military has played a strong role in Indonesia’s petroleum sector. The first head of Pertamina, General Ibnu Sutowo, also controlled one of its predecessor companies. According to Ascher (1999, p. 61), “The heritage of Pertamina was a set of practices dedicated to augmenting the revenues of the armed forces and an instinct to keep the operations and financing secret.” A key political challenge for President Suharto was to maintain support by the military, which had been instrumental in the downfall of Sukarno, his predecessor. Since Indonesia was trying to court donors, “an openly defense-heavy national budget would have looked very bad; international borrowing beyond agreed limits would have looked even worse . . . . Thus, as a way to finance the armed forces without the visibility of central government spending, a huge but unknown portion of Pertamina revenues went to the military” (Ascher 1999, p. 61).

Similarly, some 10 percent of Chilean Codelco’s copper export revenues apparently continue to go directly to the Chilean armed forces. This arrangement, which was established by the Frei government of the late 1960s, may have accounted for about one-third of Codelco’s “tax” obligations during the 1980s. The arrangement “reflected a political convenience for the president, congress, and the armed forces
to have an automatic appropriation rather than having to debate and justify the full military budget each year . . . . Executives and legislators were no longer held accountable for this component of military spending” (Ascher 1999, p. 165).

In general, there is a wide body of research on the negative implications of earmarked funds for good governance. Essentially, earmarking means that society is not able to evaluate the marginal social benefits of all programs and rearrange spending as priorities change. Giving programs their own source of revenue makes them less accountable to society as represented by Parliament and central budget authorities. Lack of accountability by the military to the civilian authorities is particularly worrisome in this regard.

A related problem is the use of natural resources to fund rebel movements (and in some cases governments), usually involving resources that are technically relatively easy to extract, such as alluvial diamonds and timber. There is a growing body of research on the influence of such resources on the length and nature of civil conflicts in various developing countries and how they should be addressed.

12 Initiatives That May Improve Transparency of Resource Revenues
This section describes important international public and private instruments and initiatives that could have a positive impact on the transparency of resource revenue flows.

13 The initiatives fall into two basic groups: initiatives primarily relevant for host-government reporting and initiatives primarily relevant for company reporting. There is some degree of overlap for several of the initiatives. Some also contain a role for companies’ home governments, which in principle could be encouraged to influence companies based in their jurisdictions.

Initiatives Relevant for Host-Government Reporting
In this section, we consider three groups of initiatives aimed at promoting host-government reporting of the resource revenues they receive: several initiatives of the International Monetary Fund, the Forest Law Enforcement and Governance ministerial process, and the efforts of the Caspian Revenue Watch.

IMF Initiatives. Several IMF initiatives could be used to promote transparency of host governments’ revenue flows from natural resource extraction and export. Most notable is the Code of Good Practices on Fiscal Transparency. Related to this are reports on the observance of standards and codes (known as ROSCs).
The IMF’s fiscal transparency code represents the first coherent attempt to set a framework of international standards for the conduct of fiscal policy (Petrie 1999). The IMF adopted the original fiscal transparency code in 1998, while the latest version (as of October 2002) dates from March 2001.

The fiscal transparency code can be used to evaluate a country’s fiscal transparency. It includes a supporting manual, which provides guidelines for implementation, a questionnaire, and a summary self-evaluation report, all of which can be found on the IMF fiscal transparency website.

The code defines fiscal transparency as “being open to the public about the structure and functions of government” (IMF 2001c). It provides a set of practices for making fiscal management transparent. Public availability is a key element. The code is based on the assumption that, over time, fiscal transparency will result in good governance, which leads to more equitable and efficient fiscal policies, which in turn are important for achieving macroeconomic stability and growth. The objectives of the fiscal transparency code are as follows (IMF 2001c):

• Clarity of roles and responsibilities is concerned with specifying the structure and functions of government, responsibilities within government, and relations between government and the rest of the economy.
• Public availability of information emphasizes the importance of publishing comprehensive fiscal information at clearly specified times.
• Open budget preparation, execution, and reporting cover the type of information that is made available about the budget process.
• Assurances of integrity deal with the quality of fiscal data and the need for independent scrutiny of fiscal information.

Each main principle embraces a number of specific principles and good practices. Implementation of the code is voluntary. Although the IMF is encouraging its 184 member countries to improve fiscal transparency by meeting the requirements of the code, member countries are under no formal obligation to adhere to it.

The fiscal transparency code can be used as one step in the fiscal module of a ROSC. The ROSC is a joint effort by the IMF and World Bank to summarize the extent to which a country observes certain internationally recognized standards and codes. The IMF has identified
11 areas and associated standards, based in large part on the fiscal transparency code and on the Code of Good Practices on Transparency in Monetary and Financial Policies. ROSCs are prepared and published at the request of a World Bank or an IMF member country, and countries are not under a formal obligation to request them. ROSCs can be used in policy discussions with national authorities and by the private sector (including rating agencies) for risk assessment. The information in a ROSC is extensive but varies by country.

17 The fiscal transparency code makes specific recommendations on the publication of fiscal information. The following recommended practices are relevant to resource revenue transparency (IMF 2001c):

- The public should be provided with full information on the past, current, and projected fiscal activity of government.
- The budget documentation, final accounts, and other fiscal reports for the public should cover all budgetary and extrabudgetary activities of the central government, and the consolidated fiscal position of the central government should be published.
- The central government should publish full information on the level and composition of its debt and financial assets.
- A commitment should be made to the timely publication of fiscal information.
- The publication of fiscal information should be a legal obligation of government.
- Procedures for the execution and monitoring of approved expenditure and for the collection of revenue should be clearly specified.

Although the fiscal transparency code and fiscal ROSC do not specifically address resource revenue, they emphasize good practice related to all significant sources of revenue. Therefore, the more significant resource revenues are in a country’s overall revenue picture, the more the ROSC is likely to focus on these revenues. For example, if revenues accrue to an extrabudgetary fund, a ROSC would highlight the need to make the operation of this fund transparent. In addition, the IMF’s Government Finance Statistics Manual, which the fiscal transparency code recommends using, suggests how data on revenues from natural resources should be reported (IMF 2001b). Among other countries, Azerbaijan has prepared a ROSC, including the element of fiscal transparency. Box 3.1 shows some findings from the Azerbaijan

Box 3.1 The Azerbaijan ROSC
The ROSC refers to problems of tax administration and tax arrears of many large state enterprises, including SOCAR, the state oil company.
The report from 2000 admits that transparency could be improved: “Although information is not secret, there does not seem to be a strong commitment to regularly publish fiscal data of a comprehensive nature.”

According to IMF staff commentary, some of the top priorities for Azerbaijan are to “develop a medium-term budget framework to take into account future income from oil resources and to set development priorities [and] ensure that the operations of the Oil Fund will be transparent.”


ROSC that are relevant to the issue of transparency of natural resource revenues.

The impact of the fiscal transparency code and ROSC depends on the participation of member countries. In some cases, the IMF has put pressure on governments with an IMF program to undertake a ROSC, and in others it has placed some conditionality on ROSC recommendations. The problem is that countries with large resource revenues are, by definition, less likely to have an economic incentive to participate in IMF programs.

Even if a country undertakes a ROSC, publication is voluntary. As of April 2002, ROSCs had been completed for 76 countries (not necessarily including all modules). Of these, reports for 59 countries were published. The IMF notes that the bulk of ROSC modules completed since January 1, 2002, have been for transition, developing, and emerging market countries (IMF 2002). However, among the countries that published the module on fiscal transparency, the list of developing countries with significant natural resources is short. The IMF argues that publishing ROSCs should remain voluntary to increase cooperation and country ownership in the process.

As long as ROSCs are published, there should be opportunities for the public to use the information. According to the IMF website, ROSCs are “used to help sharpen the institutions’ policy discussions with national authorities, and in the private sector (including by rating agencies) for risk assessment.”

There is at least one confirmed example of the fiscal transparency code being used by nongovernmental organizations (the Institute for Democracy in South Africa and the Center on Budget and Policy Priorities in Washington, D.C., according to Fölscher, Krafchik, and Shapiro 2000). However, this was not related to transparency of resource revenues.

In theory, civil society can pressure governments to undergo a ROSC.
and to improve standards and procedures by using the outputs of a ROSC. However, even in cases where a government has decided to publish the report, the operations of civil society could be hampered if freedom of the press is inadequate. Since publication of the fiscal ROSCs clearly shows how well a country’s practices are aligned with the fiscal transparency code, it theoretically provides an incentive to improve. Countries are encouraged to publish short updates every few years, although this is voluntary. A task force on implementation of standards has suggested using World Bank and IMF policy dialogue with countries to improve their standards as a more proactive approach (IMF 2001a). Again, this assumes that the country has an incentive to work with the IMF in the first place.

Important steps forward could be to increase the number of countries completing a fiscal ROSC, improve the ratio of published reports, and increase the number of recommendations implemented. Another would be to address resource revenues explicitly in the fiscal transparency code, as the importance of this issue is gaining recognition.

To sum up, the fiscal transparency code has both potential strengths and weaknesses:

• The code offers a practical and fairly detailed standard for fiscal transparency.
• The IMF may offer assistance to help countries to achieve transparency.
• Vesting these initiatives with the IMF makes sense because of its strong position both globally and at the country level.
• However, ROSCs are voluntary, and only a small number of resource-rich developing countries have undertaken them.
• Even after undertaking a ROSC, publication is not mandatory.

The Forest Law Enforcement and Governance Ministerial Process.

In 1998 the G-8 launched an Action Program on Forests, which, together with the World Bank’s Forest Governance Program, led to the East Asia FLEG (Forest Law Enforcement and Governance) ministerial conference in September 2001. An important goal of the FLEG process is to increase the amount of forest-related rent that accrues to the government and to prevent the illegal appropriation of such rent, including via illegal logging.

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Box 3.2 Highlights of the East Asia FLEG Ministerial Declaration

• Improve forest-related governance in order to enforce forest law, improve the enforcement of property rights, and promote the independence of the judiciary
• Involve stakeholders, including local communities, in decision-making in the forestry sector, thereby promoting transparency, reducing the potential for corruption, ensuring greater equity, and minimizing the undue influence of privileged groups
• Review existing domestic frameworks for forest policy and institute appropriate reforms, including those relating to granting and monitoring concessions, subsidies, and excess processing capacity, to prevent illegal practices.

The following is an indicative list of actions for implementation of the declaration:
• Institute systems that encourage responsible behavior and deter criminal and corrupt behavior (for example, salaries, codes of conduct)
• Provide consistent, accurate, and timely information to monitoring organizations
• Develop and implement a transparent and participatory approach to the allocation of concessions.


The ministerial conference included participants from 20 countries, representing governments, international organizations, nongovernmental organizations, and the private sector. It produced a statement expressing political commitment for action in the area of forest law enforcement and governance at the national and regional levels (see box 3.2 for highlights of the declaration).

More recently, ministers from several African countries have expressed interest in a similar initiative. The World Bank (with sponsorship from France, the United Kingdom, and the United States) has been asked to convene an African FLEG ministerial process in 2003. Both the East Asia FLEG and the Africa FLEG are continuing processes with dedicated websites.

Some of the commitments made in the East Asia FLEG declaration are relevant to the issue of resource revenues—for example, the calls for ensuring transparency and for reducing the incentives for corruption. Furthermore, the declaration covers numerous aspects that are interlinked, such as property rights.

There appear to be no control mechanisms for enforcement or follow-up of the principles endorsed by East Asia FLEG. The website states that the ministerial declaration commits participating countries to “intensify national efforts and strengthen bilateral, regional, and multilateral collaboration to address violations of forest law and forest crime and create a regional task force on forest law enforcement and governance to advance the declaration’s objectives.”
A task force met in May 2002 and is due to meet again in 2003. It is unclear whether the declaration will be adopted. The impact of the Africa FLEG initiative is difficult to evaluate at this relatively early stage. It is noteworthy, however, that the FLEG process has expanded to include other geographic regions. Therefore, the initiative’s strong and weak points are as follows:

- It is the only initiative that requires host-country endorsement.
- It includes possibilities for civil society influence.
- It is still in the early stages, so its impact in practice is still unclear.
- It includes no mechanisms for monitoring implementation.
- The issue of revenue disclosure is not specifically addressed.

*Caspian Revenue Watch.* The Caspian Revenue Watch policy program is a relatively new initiative of the Open Society Institute, which in turn is a part of the Soros Foundation.

It was established to explore how revenues are being invested and disbursed and how governments and extraction companies are responding to civic demands for accountability in the region. It also contains a strong advocacy component, aiming to ensure that “existing and future revenue funds in the region be invested and expended for the benefit of the public, such as poverty reduction, education, and public health—through the promotion of transparency, civic involvement, and government accountability.”

Although the ultimate focus is on how revenues generated by natural resources can benefit development within the Caspian region, transparency of these revenues is very much highlighted. Moreover, transparency and accountability of resource revenues are specific objectives of Caspian Revenue Watch. The Eurasia Policy Forum notes that the report that eventually will be issued will offer “in-depth analysis and policy recommendations useful to donors, national governments, nongovernmental organizations, and the media.”

However, since neither the report nor the expected recommendations have been published yet, it is difficult to evaluate the impact of the program. Caspian Revenue Watch focuses almost exclusively on flows going to natural resource funds rather than on flows moving through the...
central budget. On the one hand, a fund in a nontransparent system could facilitate the plundering of resource revenues. On the other hand, the spotlight provided by Caspian Revenue Watch could make it more difficult for this to take place. In general, however, it probably will be difficult to create an island of transparency in a system that lacks transparency overall. For this reason, Caspian Revenue Watch may wish to consider expanding its agenda to include the transparency of resource revenues in general, particularly through the central budget.

To sum up, the potential strong and weak points of Caspian Revenue Watch are as follows:

- The advocacy approach may help to raise awareness of transparency issues.
- A strong civil society “spotlight” on the funds could make them more difficult to plunder.
- If the existence of funds in nontransparent systems can actually increase transparency problems, Caspian Revenue Watch’s advocacy of such funds may be problematic.
- Caspian Revenue Watch focuses on funds rather than the national budget.

Initiatives Relevant for Company Reporting

In this section, we consider initiatives and instruments aimed at promoting company disclosure of the payments they make to host countries.

OECD Guidelines for Multinational Enterprises. The OECD Guidelines for Multinational Enterprises are nonbinding recommendations that governments address to all companies based or operating in their jurisdictions. The guidelines form part of the OECD Declaration on International Investment and Multinational Enterprises, which has been agreed to by 33 OECD governments and several non-OECD governments (Argentina, Brazil, Chile, and Slovakia). Since their introduction in 1976, the guidelines have been updated several times, most recently in 2000 (OECD 2000). They take the form of recommendations divided into the following topics: disclosure, employment and industrial relations, environment, efforts to combat bribery, consumer interests, science and technology, competition, and taxation. The consultation process used to develop and revise the guidelines has been relatively open and includes input from several permanent advisory bodies that coordinate the positions of interested business and civil society groups.

What differentiates the OECD guidelines from other recent initiatives is that they have been adopted by governments, not just nongovernmental organizations and companies. Although companies do not endorse the guidelines, and observance is voluntary and not
legally enforceable, signatory governments commit to encouraging compliance by “their” companies. Each adhering government is obligated to set up a national contact point, responsible for promoting the guidelines, handling inquiries about their application, and resolving disputes.

The OECD guidelines from 2000 recognize the importance of transparency and disclosure, but they do not specifically focus on disclosure of payments. The most relevant parts are as follows (OECD 2000):

- Enterprises should ensure that timely, regular, reliable, and relevant information is disclosed regarding their activities, structure, financial situation, and performance. This information should be disclosed for the enterprise as a whole and, where appropriate, along business lines or geographic areas. Disclosure policies of enterprises should be tailored to the nature, size, and location of the enterprise, with due regard paid to costs, business confidentiality, and other competitive concerns.

- Enterprises should apply high-quality standards for disclosure, accounting, and audit. Enterprises are also encouraged to apply high-quality standards for nonfinancial information including environmental and social reporting, where they exist. The standards or policies under which both financial and nonfinancial information are compiled and published should be reported.

Information should be disclosed along business lines or geographic areas, which could be highly relevant for reporting payments by a specific host country (although the term geographic area is somewhat vague and could be interpreted more broadly, for example, as a continent rather than a country).

The OECD guidelines potentially benefit from OECD’s credibility and intergovernmental status. However, they are not as well known internationally as other global instruments (OECD 2001b, p. 4).

The OECD guidelines are unique among aspirational voluntary codes in having a mechanism to address breaches. National contact points are key actors in the mechanism to resolve disputes—for example, allegations brought by one party against another for failing to observe the guidelines. If a company proves uncooperative, the national contact point can resort to the scheme’s greatest sanction, essentially “naming and shaming.” In principle, this could be an important deterrent for companies. In practice, however, the scheme suffers from a lack of will on the part of most home governments to address the breaches.
will not act against companies that fail to publish such information. The guidelines are not legally binding on companies, in contrast to, for example, the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, which, according to Mack (2002, p. 8), is “an example of how regulation can enhance the interests of the private sector as a whole by helping create a level playing field.” Although governments may still be committed to encouraging observance, the real strength of mechanisms for adherence is questionable.

As is the case for a number of initiatives, the OECD provides a dynamic framework for developing and revising the guidelines. Moreover, their authority and credibility are potentially enhanced by the transparent and inclusive way in which they have been developed. This ongoing process could be used to facilitate further refinement and even strengthening of the guidelines. Possible improvements to the existing framework could include offering more specific recommendations on company disclosure as well as specifying individual countries, instead of geographic location, as the unit of reporting.

Making the guidelines legally binding for companies does not appear to be a realistic option. Nevertheless, if the political will exists, one option is to negotiate a more selective version in which national governments commit themselves to enact relevant national laws, similar to the model of the OECD antibribery convention. At a minimum, individual home governments can draw on the guidelines in creating relevant national laws.

To sum up, the potential strong and weak points of the guidelines are as follows:
- They include the critical feature of (home) government commitment.
- They feature a mechanism for dealing with breaches.
- They may not be specific enough on the disclosure of payments.
- Many adhering governments may lack the political will to enforce them.

**UN Global Compact.** The UN Global Compact is a voluntary code of conduct first proposed by UN Secretary General Kofi Annan in a speech to the Davos economic forum in 1999.

Essentially, the secretary general warned that business leaders needed to take more substantial voluntary actions in the areas of human rights, labor standards, and environmental practices in order to counter the “enormous pressure..."
from various interest groups” to include mandatory standards in these areas in international trade regime and investment agreements. The compact was subsequently fleshed out during a series of meetings between representatives of the United Nations, business, and labor. Its operational phase began in 2000.

The nine principles of the Global Compact cover the areas of human rights, labor, and the environment, areas in which universal values have already been defined by international agreements, notably the United Nations Universal Declaration of Human Rights, the International Labour Organisation Fundamental Principles on Rights at Work, and the (UN) RioPrinciples on Environment and Development. Each of the nine principles is explained and expanded on in a document available on the Global Compact website.

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The main requirement for participation is that companies provide a brief report once a year on concrete actions they have taken that have been inspired by one or more of the nine principles as well as any lessons they have learned from doing so. The main purpose of this reporting is to share lessons with other participants, including measures that work and those that do not. These postings are to be incorporated into an online database or “learning bank.” Participating companies are strongly encouraged, but not required, to take part in various partnership projects organized by the Global Compact. In January 2002 the Global Compact Advisory Council was formed to strengthen the governance and integrity of the initiative.

A July 2002 progress report emphasizes four main areas of activity: global and national initiatives, policy dialogues, the learning forum, and public-private partnership projects (UN Global Compact 2002b, p. 4). These areas do not address transparency directly, but they do have implicit relevance for resource revenues. Policy dialogues may have some relevance for resource revenue, given that the first of these concerned the role of business in zones of conflict; moreover, the Transparency Working Group, which was convened as part of this dialogue, recommended that home governments “enable relevant regulatory agencies, if necessary through appropriate legislation, to require local and international companies to disclose taxes, royalties, and other payments or transactions made in host countries”; that businesses “enhance transparency through public disclosure of information not subject to confidentiality clauses (financial statements, principal transaction, etc.)”; and that businesses “work with host governments and stakeholders to reduce opacity in current confidential contracts to enable greater transparency and where appropriate monitoring arrangements, help lines, etc.” Moreover, the Transparency Working Group noted that “most of the multiyear payments made
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directly to governments by foreign companies take place in the extractive industries” (UN Global Compact 2002a, p. 1). Another working group within the dialogue on zones of conflict is dedicated to revenue-sharing regimes, which deal with “negotiated agreements among companies, governments, and local communities to more equitably distribute the benefits from natural resource extraction” (UN Global Compact 2002b, p. 15).

The Global Compact attempts to improve company behavior through moral persuasion and engagement, providing the incentive of association with a prestigious institution. On the one hand, the Global Compact’s association with the United Nations is an advantage, because its “convening power at the highest possible levels provides an unparalleled opportunity for dialogue and for identifying and implementing high-profile and high-impact activities.” On the other hand, the UN association may carry a number of potential drawbacks, such as perceived bureaucracy and inefficiency. Although many UN bodies are involved, the status of the compact within the United Nations is unclear. It neither was created by nor reports to the General Assembly, reporting instead directly to the Office of the Secretary General, apparently relying on his patronage for much of its authority. The requirements to join the compact are not very strict. On the one hand, the opportunity to participate without a substantial commitment might encourage more companies to engage. On the other hand, it is relatively easy for companies to benefit from association with the Global Compact without complying with its recommendations. Nevertheless, after reviewing the governance of the Global Compact, the Advisory Council concluded, “The procedures for joining and participating in the Global Compact should remain un-bureaucratic and encourage the entry of new companies and civil society organisations” (UN Global Compact 2002b, p. 8).

The inclusive nature of the compact is reflected in the vagueness of the specific recommendations on transparency “if necessary through appropriate legislation.” The impact of the constituent working groups thus depends on the priorities of the stakeholders involved. The Global Compact and the Transparency Working Group within the zones of conflict dialogue appear to be ongoing processes that have the potential to focus more on revenue transparency issues in the future. The most recent meeting notes from the Transparency Working Group (from April 2002, posted on its website) state that it will “continue to explore ways and means to support the ongoing process for increased transparency at the sectoral levels such as efforts in the mining and petroleum-industry sectors, multilateral development...
bank efforts on good governance, and the World Bank’s review of the
natural-resource industry.”

One possibility for having a greater impact on revenue transparency could be to expand the nine principles of the Global Compact (as op