

Poorly Governed Resource-Dependent States: Policy Options for the New Administration

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The aim of the conference was to bring about interaction between policy-makers and academics in order to constructively critique each one's perspective, and to generate proposals that bridge both arenas. In particular, policies that seemed highly innovative, like the Extractive Industries Transparency Initiative (EITI) have now been enacted, so evaluating them and moving beyond them is feasible. The underlying question remains: how can we deal with failed states that are so broken that there is no economic activity, like Somalia and Zimbabwe; with states that are, hopefully, emerging from conflict, like the Democratic Republic of the Congo, Afghanistan, East Timor, and Iraq; and, with badly-governed states that only have a productive natural resources sector, like the Sudan, Burma, and Chad. How can we use these states' own resources to help these failed and failing states? What should be next on the policy agenda?

Policy prescriptions suggested in the conference range from important extensions of existing programs, to innovative new projects. In evaluating each of these potential recommendations, it is important to consider both the incentives they seek to influence, and the institutional framework through which they will work. In order to rigorously study the potential impact of different projects, and to decide which to implement, the first steps may be to create a program head in the U.S. to coordinate the effort here, and an international body to coordinate a much-needed collaborative effort.

International Initiatives

Two internationally enacted programs, the EITI and Oil for Development, initiate policies aimed specifically at improving development in poorly governed, resource-dependent states. Evaluating these initiatives, then, is the first step in designing effective programs to deal with these types of states. The EITI has twenty-five candidate countries, and has so far validated Azerbaijan. Norway will also implement the initiative. The program is transformative in that civil society stakeholders help increase the transparency and accountability that the program is designed to generate, especially in the longer-run, since they can call for a review of the state even after validation. The EITI also offers potential reputational benefits, as well as a better investment climate and perhaps more access to aid. However, unlike the Kimberly Process, a state can still trade its resources without joining. Future steps might include adding other standards to the regime, like disclosure from companies and higher standards for banks, as well as encouraging other states to join. The Oil for Development project seeks to offer independent advice about alternative options to states, based on the Norwegian model. Ten core states, and twenty-five overall, are involved in the program. States seek the program to improve resource management, local industry development, financial issues, and, more recently, environmental protection, and transparency and corruption advice. The project offers assistance on a state-to-state level, but also by working with non-governmental agencies in the states and larger regions.

The general idea of these initiatives, however, is that they cannot be forced upon the states, but must instead operate within the domestic institutional framework based on demand. These interventions, then, can bring three possible outcomes, in terms of incentives: they can be consistent with incentives but not change them, they can be in the elites' short-term interests and change future incentives, or they can operate under alternative incentives. In the last case, leaders are unlikely to adopt the programs. More likely, the initiatives in place represent the second class of outcomes, where the international community engages leaders on their own terms in ways that meet their current incentives, but also shifts future incentives to allow for productive change. Thus, these programs may have unintended consequences down the road for leaders, but these same consequences are intended for good development.

It is unclear whether these international initiatives, then, have the power to change incentives, perhaps in the future, but they may do so through increasing transparency or building capacity. It is possible that both of these actions lead to beneficial change in some types of states, where there are actors who will use the increased information, or capability, for progress toward effective development. Oil

booms generally impact various types of states in different ways, and these initiatives may have similar effects. They will likely provide information and strengthen the government, so this can assist in building a stronger state. If a democracy is already in place, these programs can help strengthen it, or, if reformers exist in an authoritarian state, they can assist their cause over time. Even in autocracies, various officials have different incentives, and these changes may empower those seeking reform. In semi-democracies, legislatures may prove especially useful since their approval could provide an alternative source of power to the executive. However, these initiatives can instead strengthen an autocracy if these crucial actors are not in place.

Transparency, the first mechanism through which these initiatives might affect change, may increase productive development, but likely only where there is a strongly democratic government, or a strong group of reformers. Although there is little macro-level evidence, some micro-level evidence currently supports the hypothesis that transparency improves development. Additionally, in theory, the causal logic is sound: having knowledge about capacity, and capacity loss, gives the government or its opposition a platform from which to fight corruption. In the Niger Delta, for example, installing electronic measures on each well will provide evidence of how much oil is disappearing. However, there must be social actors, inside or outside the government, who then act upon this information for positive change. Transparency may undermine other goals, such as accountability, if the regimes that foster it provide a reputational cover that allows the state to commit other violations. For example, in Azerbaijan, accolades on the EITI approval legitimize an illegitimate government that is worsening. However, if civil society is strong enough, it may petition the EITI to reinvestigate the state, thereby forcing the government to maintain or improve operating standards.

Building capacity, the other potential mechanism for affecting change, is also only likely to improve development where there are strong advocates for this change in place. Building capacity may strengthen either a good government, or a class of reformers in the states. However, capacity building can have unintended consequences. For example, corruption may merely become centralized, as in the case of the customs boards in Azerbaijan: donor aid got all the border stations connected, but this merely strengthened the autocrats' ability to grant monopolies. Nonetheless, in general, building capacity drives modernization, which will likely lead to change, and, at least in economically struggling states, this may be an improvement. As with increasing transparency, this is especially likely where the government is already fairly good, or where there is an active class of reformers with some capacity.

U.S. Initiatives

It is possible for the United States to encourage states to join programs like the EITI through its own actions, and, perhaps, to increase the program's reputational or actual effect. The Government Accountability Office will likely study how much it will cost to implement the EITI in the United States, and it may be feasible. If the United States implements the program, as Norway is doing, it could offer additional diplomatic leverage to get other states to join, and make it seem less of an imposition, especially since it would no longer appear to be a club for failing and failed African states.

One of the consequences of legitimating the program is that the U.S. must first be certain about the usefulness of this program because otherwise it may be securing the political positions of bad leaders. The reputation of the EITI needs to be improved both to get states like Brazil to join, and to make it an initiative that other states, like Russia and China, cannot ignore. There are also other programs these states might join that would be a lower cost for similar legitimacy, so, in general, the usefulness of initiatives needs to be verified. The United States can then try to use both positive incentives, like inviting foreign leaders to visit the White House, and negative incentives, like sanctions, to gain participation in the best programs for the purpose of good development.

Additionally, United States implementation of the EITI would bring many companies in, and level the playing field for them. Indeed, outside of the EITI, the United States' strongest influence may be through pressuring commercial firms to release information about contracts. The U.S. might also hold partner banks accountable for thoroughly checking that those with whom they deal in these countries are not handling corrupt government money. If the United States deems the EITI unaffordable, however, this will be difficult for the program, but this is unlikely since it is only for oil on federal land.

More generally, beyond EITI, U.S. policy-making needs to become more effective and efficient by convincing the government of the strategic value of good development in these states, by better staffing programs for that end, and by thinking through the consequences of such programs in a sophisticated manner. It is hard to change incentive structures from the outside — conditional aid may not work very well in these states — but the U.S. can change external incentives in ways that it has not yet tried. Good development in these resource rich states is crucial for the U.S.'s security of supply, but importance of the agenda has not yet been pitched effectively as such. The organization in the government then must be able to deal with the issue, which is difficult since there is currently no home for it in the State Department, or other apparatuses. Additionally, the bureaucracy of transparency initiatives may become its own problem, so this should be streamlined from the start. Finally, returning to the questions of effectiveness of the types of programs that have so far been instituted is a necessary step as the government embarks upon this agenda.

New Initiatives

Other, new initiatives might allow for better development. For countries, or sectors of society, that want maximally efficient development, the resource charter provides a useful value chain perspective on the best practices in managing finite resources over time. The guidelines include introducing competition to get a better deal, and advice on how to manage the volatile income, especially through investment at the local level.

Many states, however, have difficulty achieving maximally efficient development, or are not even seeking it. In such cases, an alternative solution may be to translate a country's natural resource wealth directly into public goods, so that a series of government failures can be avoided in between. Chinese and South Korean companies use barter contracts in many states, especially in Africa. The pros of these contracts are that they may overcome corruption, make contractors responsible for smoothing long-term projects despite resource volatility, and bind the government to multi-year development. However, their cons are that there may be corruption built into the transactions, there is little transparency on the deals, they are not highly competitive, and their longer-term consequences are unknown. Additionally, bypassing the state disables its ability to increase management and distribution capacity. In any case, these deals are likely to happen anyway, so perhaps strategies such as encouraging other companies to competitively bid for these types of contracts, fostering a competitive bidding system for the state, and ensuring that local capacity development is a component of the agreements, can overcome some important development issues in poorly governed, resource-dependent states, especially those that are truly failing. Finally, U.S. companies may be at a disadvantage since they are often not conglomerates that include development capabilities, but non-governmental organizations could mediate these deals.

Academic Perspectives

An academic perspective that emerged in much of the discussion on other topics is that institutions develop in an environment dominated by self-interested elites, so merely introducing policy to foster transparency, build capacity, and support technological development may not lead to all of the good outcomes predicted by older hypotheses, like modernization theory. Instead, such policies likely matter only if the actors in country are willing to use them productively. Otherwise, such strategies may be

irrelevant, or worse, counterproductive. More research needs to specify the conditions that make these different outcomes more or less likely. In some cases, an extremely corrupt development process may ultimately still bring positive change. Additionally, we might then be able to develop policies that focus on these incentives, such as targeted sanctions, or building up alternative power centers.

Another important contribution that also emerged in earlier discussion, but that is useful to elaborate, is that the strength of institutions appears to be a key variable for predicting the impact of natural resources on economic growth. The latest findings demonstrate that the resource curse emerges only in states with weak institutions. Three mechanisms potentially link weak institutions to the resource curse: the government may be overwhelmed by resource windfalls that force them to grow more quickly than services develop; entrepreneurs may be forced to partake in rent-seeking through corruption, rather than by being strong producers, where there are weak institutions; or, leaders may be more vulnerable, especially given the new-found wealth, and thus use it to protect themselves rather than to develop the economy. Even if there is theoretically a good institutional framework specified by the constitution, it might not be strong in practice, as in the case of Azerbaijan. Again, further research might better identify how to measure good institutions in reality, and which mechanisms lead to the resource curse where they are weak. These answers might identify other policies that overcome the problems in using these resources to improve development.

In addition to identifying problems that require further analysis, the academic perspective also generates new initiatives for helping poorly governed, resource-dependent states achieve better development. A controversial plan for assisting in longer-term development requires leaving the resources in the ground. Currently, there are two options discussed for improving bad governance of natural resources: bypass the government to sell the resources and then either provide goods privately or simply distribute lump sums to individuals, or alter government incentives through resource funds and other similar initiatives. Aid donors have tried a bit of both, and neither works very well. The alternative option, then, is to leave the resources in the ground by sanctioning to prevent companies from purchasing them. In these cases, if governance improves, the resources are still there to be used more effectively. There are drawbacks to such programs: they may give leaders a platform on which to rally popular support, they hurt citizens in the shorter-term, and it is difficult to deny either the right of countries to sell their own goods, or to keep other countries from buying them. However, it is at least an alternative to consider.

One option for creating incentives for states to spend their resource revenue wisely is to require that they sign binding contracts when initiating extraction. Leaders may be very willing to agree to stringent development plans before they have the resources in order to gain access to them, but then their incentives are likely to shift over time as wealth enters their coffers. To prevent them from renegeing on development, a contract might be signed initially with an outside party to maintain the commitment over time. Fixed term withdrawals, or a collateral hostage that will be foregone if the contract is not implemented, may produce better follow-through over time. Barter contracts may work similarly, if the payoff for infrastructure comes at the end of the project. In Chad, however, the initial investment had to be very high, and then the benefits outweighed costs in renegeing on project. The international community might have changed these incentives, but convincing each state to pull its weight in doing so was difficult. Local law might similarly alter incentives, especially where legislatures have an interest in these changes, and can ensure that the president complies.

In general, the issue of leverage, especially where it must be coordinated, is very difficult. In Azerbaijan, for example, the level of resources and the importance of the location decreased the leverage the United States has over the state. In some states with smaller shares of resources in less strategic locations, leverage is much easier to obtain. Even where leverage exists in theory, coordination between different international actors to all pressure the country for the same outcome can be challenging. An

alternative solution, then, might be “fair trade gas” where a non-governmental agency could create an index of the share of resources going to good development in different countries, and then publicize this number for portfolios of different companies at the pumps so that consumers can directly impact the process. Such publication is somewhat effective on coffee sourcing.

Other Policy Recommendations

Finally, with so many different potential solutions to the problem posed by poorly governed, resource-dependent states, prioritizing for the new administration is a crucial task. Participants in the conference highly endorsed beginning by ensuring that the U.S.’s own structure, actions, and priorities are in place. First and foremost, defining an undersecretary at the Department of State to focus on extractive resource transparency issues will allow for deliberation and implementation of different policies related to development in these states. Reshaping bilateral aid programs might enable some change, as well, although academic work so far suggests that such initiatives are generally ineffective in obtaining results. Additionally, U.S. legitimization of different states and programs seems to be influential, and, thus, should be used to promote this agenda. Finally, some focus on easier cases, like Ghana and São Tomé and Príncipe, with domestic programs, may generate successes, and learning about how to achieve these successes.

Signing on to programs that are already underway may also have a substantially positive impact. As previously discussed, implementing the EITI in the U.S. may increase the program’s legitimacy and membership. Additionally, the government might greatly assist publish what you pay advocates by passing the Extractive Industries Transparency Disclosure Act (EITD), which would require all of the companies registered with the Securities and Exchange Commission (SEC) to make their payments to foreign governments for natural resources public. Finally, expanding monitoring and assigning responsibility for banking may minimize the ability of leaders to hurt the development process. Standards for monitoring fund owners, and partner banks, may lead to less corruption. Controls on capital flows that have been enacted to hinder drug trade and terrorism might also be used for this purpose. This will not eliminate corruption, as there is still the question of how contracts were created and distributed, but it could reduce it by ensuring there are legitimate contracts in place.

Proposing innovation, both through international competition and cooperation, may also be useful. A pilot project to help companies form consortia to compete with existing Chinese bids for barter contracts might improve public goods provision in the most desperate states. Additionally, coordinating with other states, especially China but perhaps beginning with our close allies, the U.S. could form a working group of future consumer countries to generate research and recommendations on how to proceed. Suggestions that could be tried in this forum include initiatives like leaving the resources in the ground until a state’s governance is sufficient to manage resource wealth effectively for development.

Thus, overall, policy prescriptions range from important extensions of existing programs to highly innovative new projects. In choosing between them, it is important to consider both the incentives they seek to influence, and the institutional framework through which they will work. Initiation of rigorous study of the potential impact of these different projects begins with both a point person in the U.S. to direct these efforts here, and an international body to coordinate a much-needed collaborative effort. Some combination of these two bodies, then, can sort through the many policy recommendations on how to improve development in poorly governed, resource-dependent states.