OIL FOR THE PEOPLE: A SOLUTION TO THE "RESOURCE CURSE"

By Nicholas Shaxson[1]

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Introduction: a proposal for directly distributing mineral revenues to citizens.

The notion that mineral-dependent countries like Nigeria or Iraq are afflicted by a "Resource Curse" is now well established in academic literature. These countries tend to grow more slowly, their citizens are (paradoxically) poorer on average, their governments are more corrupt and authoritarian; and they are more prone to conflict than other countries not dependent on minerals.

The three leading policy prescriptions currently recommended for tackling the Curse - first, setting up oil funds (such as Norway's) to keep money outside of a producer economy, to smooth volatilty and to mitigate absorption problems; second, boosting transparency; third, diversifying an economy away from the resource - are potentially useful, but in practice the effectiveness of each has been limited, especially in countries most strongly affected by the Curse where it has been hardest to implement these measures.

The main reason for this failure is that such approaches mostly do not address the fact that rulers in mineral-dependent states tax mineral companies, not their citizens, thus bypassing healthy processes of citizen-state accountability and state-building that occur when governments tax citizens directly. The only way to address this problem seriously is a more radical approach: distribute mineral revenues directly and equally to all of a

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country's citizens, and only allow the governments to access this wealth by taxing its citizens directly. This would transform the citizen-state relationship and provide dramatic welare benefits. This proposal is not new, but the author's analysis contains several new elements. It is based on 15 years' work in and around the oil-rich countries along West Africa's coastline.

Such a scheme would imply a revolutionary redistribution of wealth and income from rich to poor. It would also represent a radical democratisation of economic decision-making. It has nothing to do with privatisation, as some people mistakenly believe. Many objections have been raised against this proposal, but all except one can be overcome. The outstanding objection – that it will be difficult to implement – is true, but there are strategies available to overcome the difficulties.

For political reasons the World Bank, aid agencies, mineral companies and other actors – worried about annoying the rulers of powerful mineral-rich nations - have been unable or unwilling to promote this idea. This paper will propose that the Tax Justice Network, which does not suffer from these constraints, should actively promote it.

1. Overview

Mineral-rich countries are enjoying the biggest financial bonanza in history. Many countries in the developing world are enjoying high headline growth rates – but past experience and early indications amid the current boom suggest that these resource-rich countries not only are not translating this into real human development, but are likely to see their populations actively impoverished. This is because of what is now widely recognised as the "Resource Curse" (or "Paradox of Poverty from Plenty",) a solidly grounded thesis based on academic and other research which has found that mineral-rich states tend to be poorer, more conflict-prone, more authoritarian, more unequal, and more corrupt and dysfunctional than their non-mineral peers.

The Resource Curse thesis rests on a long historical trail of evidence: several studies, for example, have seen the the Curse to the disastrous economic effects suffered by Spain after its colonisation of the New World, which brought it unheard-of riches, followed by economic and political disaster.

To take just one example of the Resource Curse in its modern form: Nigeria received an estimated $530 billion[2] in oil revenues from 1965-2005, and yet by the end of this period

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[2] Author's calculations. The IMF publication *Addressing the Natural Resource Curse: an illustration from Nigeria*, IMF WP/03/139, July 2003, estimated that Nigeria had received US$ 350 billion in actual oil revenues from 1965-2000, in 1995 dollars. Converting that to 2006 dollars (using this table http://oregonstate.edu/cla/polisci/faculty-research/sahr/cv2006.pdf) yields a figure of $447 billion in 2005 dollars, for 1965-2000. After that, Nigeria received approximately $80bn in revenues from 2001-2005: calculated from various IMF Article IV reports for Nigeria. The resulting $530bn is a headline

its Gross National Income (GNI) per capita was 25 percent below the Sub-Saharan African average, and even below the average for the low-income group of countries. Nigerians' life expectancy today is below the sub-Saharan African average.[3]

The Curse is not inevitable: some countries, such as diamond-rich Botswana and oil-rich Indonesia, appear to have prospered in spite of their natural wealth. Yet these are exceptions to what is a clear and statistically significant set of trends.

Three broad, inter-connected reasons are generally given for the Resource Curse. First is the **Dutch Disease**: inflows of mineral revenues drive up domestic price levels (appreciaton of the real exchange rate is the term that economists like to use), making it hard for economic sectors producing goods that can be traded – such as agriculture or manufacturing – to compete against imports. Theory and experience have both shown that these sectors tend to wither, with very harmful effects. These sectors, which generate mass employment, are replaced with a high-income sector with very low employment potential,[4] which becomes an enclave – into which the country's most skilled and educated workers will be drawn, further weakening the other sectors. The second element is the impact of **price and revenue volatility**. Consider, for example, that 95% of Angola's exports are made up of petroleum (and if diamonds, its second commodity are included, the figure rises to 99.3%[5]) and that oil prices have risen more than tenfold in the last decade. Such wild fluctuations play havoc with budgeting, causing absorption problems and many other follow-on problems. The third reason given for the Resource Curse is the effect that mineral revenues have on **political conditions and governance**. Of the three main reasons this is the most complex, and the most important. Arguably the key component of this "governance" aspect of the Resource Curse relates to taxation. In short, while taxation in "normal" (i.e. not mineral-dependent) economies like Denmark or South Korea builds up strong institutions and healthy relationships of accountability through (especially direct) taxation – where governments and rulers tax citizens, and citizens demand accountability in return – taxation in mineral-dependent states is different: rulers tax the mineral-extraction companies, not the citizens – so the relationships of accountability and the state-building imperative are lost, with exceedingly harmful impacts for governance. (The political and governance aspects of the Resource Curse are discussed in more detail in Sections 2-4, below.)

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figure for illustration only; no attempt has been made to make Purchasing Power Parity calculations.

[3] Nigeria at-a-glance, World Bank, http://devdata.worldbank.org/AAG/nga_aag.pdf The life expectancy data is especially surprising given that Nigeria's HIV prevalence is below the sub-Saharan African average.

[4] Angola's oil in 2006 generated 96% of exports, 81% of government revenue and 58% of GDP (IMF, 2007, p. 44-46) but fewer than 0.2% of jobs. See *Political Economy of African Mineral Revenue Deployment: Angola, Botswana, Nigeria and Zambia Compared*, Richard Auty, June 16, 2008, p12. In Equatorial Guinea, oil accounts for an astonishing 85% of GDP (http://www.imf.org/external/pubs/ft/scr/2008/cr08156.pdf).

[5] Angola: *Selected Issues and Statistical Appendix*, IMF, October 2007, p53

Development institutions, academics, and others have offered a few broad solutions for the Resource Curse. One is to set up **oil funds**: to keep these harmful rents outside national economies – so as to curb the Dutch Disease; to smooth out revenue volatility; to save money for future generations; and to mitigate the governance problems that emerge from mineral revenue windfalls. A second approach is **economic diversification**: focus on growing alternative sectors to reduce the dominance of the mineral sector. A third approach involves **transparency**, with the idea that better information will "enable citizens to call their governments to account." Recently the Tax Justice Network and others have sought, with some early success, to expand the transparency debate to the international financial system. A fourth, less widely used and newer approach (not yet wholeheartedly endorsed by the World Bank and others) is what might be called **bypass**: countries have set up special mineral-backed financing arrangements that bypass the inefficiencies in the economy (and sometimes bypass finance ministries entirely), to make sure that roads, railways, bridges and other projects are financed and executed. The use by China, Brazil and other countries of credit lines, backed by special oil financing arrangements, would be examples of this.

While all of these proposals appear to be extremely good ideas in theory, however, the record for all of them on the ground has so far been patchy, and in some cases woefully inadequate.[6] Various reasons explain these failures; they will be discussed a little more below.

A **fifth proposal,** however, has been raised: distribute oil (or other mineral) revenues *directly* and on an equal basis to all the citizens of mineral-rich countries, meaning that the government then has to tax its citizens directly to obtain its state revenues. This has already been proposed in a few leading academic journals, notably in Foreign Affairs,[7] in IMF working papers,[8] and by a few economists (such as Tim Harford[9]) and academics (such as Martin Sandbu[10] of the Wharton School of Business.) It should be noted that this is the *only* proposal in the Resource Curse toolkit that seriously addresses the taxation dimension of the problem. More broadly, this paper contends that this is also the *only* proposal that can fundamentally and decisively overturn the drivers of conflict, corruption, authoritarianism and poverty that blight mineral-rich countries.

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[6] It is probably too early to pass definitive judgement on transparency, which as a globally-accepted idea is still relatively new. Nevertheless, it is my considered judgement that early signs in the mineral-dependent states are not especially encouraging.
[7] *Saving Iraq From Its Oil* by Nancy Birdsall and Arvind Subramanian Foreign Affairs, July/August 2004
[8] *Addressing the Natural Resource Curse: an Illustration from Nigeria*, IMF WP/03/139, July 2003
[9] See, for example: *The Real Curse of Oil*, by Tim Harford, Open Democracy, oct 17, 2003
[10] See "*Natural Wealth Accounts: a Proposal for Alleviating the Natural Resource Curse*", World Development, Vol. 34, No. 7, pp 1153-1170 (July 2006).

It is also crucial to note that this paper – unlike most academic papers supporting it – is based on 15 years' detailed on-the-ground research as a journalist (for the *Financial Times*, the *Economist Intelligence Unit*, *Africa Confidential*, and many others) and as a consultant and researcher (for project such as Dfid's landmark *Drivers of Change*[11] studies), in what may be the world's worst Curse-afflicted zone: the oil-rich West African coastline. As far as I am aware, there is no journalist or academic researcher in the English-speaking world who has as much on-the-ground research experience of this region in terms of the links between oil, politics and economics, and the links between those themes and the growing body of Resource Curse research.[12] The purpose for saying is not self-publicity but is a defensive measure against a very common tendency by people who are presented with this proposal - to dismiss it out of hand without thorough consideration. This is not a proposal plucked out of the air from abstract political theory. It is rooted in an unusually long and deep cross-country experience on the ground in Western Africa's oil zones.

It is my opinion that widely reported dismissals of this proposal have been, with only one full (and one partial) exception, without merit. The dismissals are, in my experience, too often based on inapplicable and inappropriate ideologies, prejudices; or a simple lack of knowledge about these rather alien economic and political systems; or even just on a gut feeling that such a radical project is simply too radical to be taken seriously. For example, some have rejected this proposal instantly, based on an assumption that it represents a form of privatisation – perhaps akin to the failed privatisations in Russia after the fall of the Soviet Union. It is, as is explained below, absolutely nothing of the kind.

It is, in fact, rather ideologically neutral: it should appeal to those on the ideological left because it represents what would amount to the greatest possible redistribution of wealth from rich to poor; it should appeal to those at the other end of the political spectrum because it takes unearned rents out of the hands of governments and puts them into the hands of private citizens. Crucially, however, *the government still gets a large share of its oil revenues* – but it gets them as a result of direct taxation of, and bargaining with, citizens, instead of directly from the oil source which bypasses the citizenry. The government will clearly get less than the total – but it is the quality of the revenues, not their quantity, that matters most here: Angola, for example, had a budget of $31 billion last year – as much money as all OECD countries' foreign aid to all of sub-Saharan Africa – and yet its infant mortality is the second worst in the world, according to the UN.[13] There is no evidence that more money for Angola is the best solution to its deep-

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[11] http://www.gsdrc.org/go/topic-guides/drivers-of-change#ang

[12] There are certainly long-standing journalists and researchers with more knowledge than myself of specific countries in oil-rich West Africa; there are also journalists such as Barry Morgan of Upstream magazine with more extensive knowledge of the region's oil industry itself, but who have not delved as deeply (at least in their published work) into the all-important nexus where oil, politics and economics meet. See also my book on this subject *Poisoned Wells: the Dirty Politics of African Oil*, Palgrave MacMillan, 2007

[13] UN Human Development Report 2007/2008: http://hdrstats.undp.org/indicators/336.html

rooted problems. Under this proposal, the money that the government doesn't get (the part that the citizens keep) does not go up in smoke: it will have dramatically positive welfare (and other) effects, as explained in Section 7 below.

One of the objections is partially valid: it has major implications for the exercise of sovereignty (this aspect is dealt with in Section 6.2 below). Only one objection is fundamentally valid: that this would be exceedingly difficult to achieve in practice, for two main reasons. First, it would be technically very difficult to implement, especially in badly-governed countries; and second, the politicians would never accept it (and turkeys would not vote for Christmas either.)

There are several answers to the correct assertion that such a proposal would be hard. Broadly, like many issues such as the fight against international tax evasion or against drug smuggling, the fact that a good proposal is difficult to implement is absolutely no reason not to attempt it: indeed, it constitutes grounds for trying especially hard.

More specifically, we should separate this question into two issues: **first**, would this be the right thing to do, if it could be done; and **second**, could it be done? The answer to the first question, as this paper explains below, is a resounding yes. The answer to the second question is a qualified one, and more complex. This is discussed in more detail, in Sections 6 and 7, below.

Direct Distribution is not appropriate, or possible, for all (or currently even most), mineral-rich countries, at least today. But this paper contends that it will be appropriate for some of them, and there are reasonable strategies for overcoming the biggest difficulties.

Mnidful of the turmoil in places like the oil-rich Niger Delta of Nigeria, it is clear that the bar is set so very low in terms of development in mineral-dependent states in the developing world, that the potential benefits of this scheme do not need to be very large to be worth it. As it happens, however, the benefits could be very large indeed.

2. Fragmentation: the essence of the problem

Two of the three important reasons for the Resource Curse – the Dutch Disease and price/revenue volatility – have been briefly summarised above, and will not detain us further. It is the governance effect that is worth examining in more detail. As George Soros said in the foreword to an important new book on the subject[14]:

"The third effect is the effect on political conditions. The first two (Dutch Disease and volatility) are purely economic and have been studied extensively. It is the third factor that needs to be better understood, especially as its impact is far greater than that of the other two."

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[14] *Escaping the Resource Curse*, Eds. Macartan Humphreys, Jeffrey D. Sachs and Joseph E. Stiglitz, Columbia University Press, 2007. Quote is on the first page of the foreword.

This paper takes into account prevailing theories of the Resource Curse, but, based on 15 years' research into, and experience of, the politics and economics of oil-rich nations of West Africa, aims to provide some new and alternative, and hopefully deeper, insights into the political effects of mineral dependence. These insights lead to a conclusion that direct distribution is the best solution for the countries where it is possible to implement it – quite apart from the (very large) welfare effects.

There is a fairly wide consensus that mineral-rich countries tend to be more authoritarian, more conflict-prone, more corrupt, and more unequal and poverty-stricken than their peers. (It should be noted that there is some reasonable disagreement between experts on the degree to which these countries tend to be affected.)

The ultimate origins of these problems can be boiled down to a single word: **fragmentation**. In essence, mineral revenues flow or trickle downwards through national politics and society, and in the process factions compete or fight for their share of the proceeds. This competition for resources exacerbates existing social or political divisions (such as regional, religious or ethnic rivalries), and it creates new ones. The competition is a zero-sum game: more for one faction or region means less for the others – and this makes the difficulties more intractable and the competition fiercer.

In these societies political relationships are vertical: to put it crudely, rulers allocate resources downwards, in exchange for political support, and underlings scramble, lobby and fight among each other for access to those resources. To give an example, a recent banking survey in Angola described one of the key problems like this:

"The tendency (by the government) to view the financial system as a conduit for subsidizing favored sectors through cheap credit. These schemes are usually captured by special interests, at the expense of development goals."[15]

In this above sentence, notice the word "usually" – it is accurate.

This kind of system stands in contrast with more "normal" nations such as France or the United States or Taiwan, where wealth is generated in widely distributed ways, and where citizens co-operate with each other (horizontal relationships) through trade and other means in order to generate wealth for themselves. These horizontal links of co-operation tend to repair, rather than exacerbate, the political and social fragmentation. This is a great simplification, of course, but it is not an inappropriate one.

The fragmentation in mineral-dependent nations happens at all levels, from the highest echelons down to the village level, as resources flow (or trickle) downwards. It reinforces existing fractures in societies: ethnic or religious divisions, or regional rivalries, for example, and it often creates new schisms.

[15] *Developing the Supply of Financial Services and Improving the Efficiency of the Banking Sector in Angola*, Submitted by: The Services Group, Inc. and Nathan Associates, Submitted to: U.S. Agency for International Development/South Africa, January 2008

The fragmentation shows itself in many different ways. In Angola, for example, it is visible in the competition between factions at the presidency and ministries and the state oil company Sonangol and other state-linked bodies, for permission to access certain parts of the revenue streams. As the president plays factions off against each other in the exercise of power, he ensures that no single institution (even the Finance Ministry) has a coherent picture of the total revenue stream: Sonangol manages some flows through a system which the World Bank has described as the "dual spending system" with Sonangol operating the "non-conventional" part of it[16] and which have generated discrepancies that non-governmental organisations like Global Witness and Human Rights Watch have dubbed "Angola's missing billions."[17] These discrepancies stem from the nature of political power and divide-and-rule politics exacerbated by Angola's mineral dependence.

In Nigeria, to give another example of the fragmentation, secessionist and criminalised armed groups in the unruly oil-rich Niger Delta region compete with each other for access to sources of largesse, either from the oil-financed Niger Delta Development Commission (NDDC), or from different arms of the federal or state governments (even oil licences themselves, in one case[19]) or directly from the oil companies, in the form of construction or security contracts. National laws are no impediment to the disruptive effects. As one recent analysis by a well-informed observer on the ground put it:

> "In the key oil producing states of Rivers, Bayelsa and Delta states the courts have been used as little more than a theatre for competing political factions to gain leverage over each other. . . . In May the Minister of Defence implied that militants would be employed for security once they 'formed themselves into limited liability companies".[21]

Conflicts can break out at all levels, even at the family level, over rights to these micro-streams of oil money, as I can attest from interviews on the ground in Nigeria. Militants routinely resort to ethnic or other narrow affiliations in order to bolster their claims to revenue opportunities: witness the widespread calls for "total resource control" by (among others) the ethnic Ijaws, whose widely-cited "Kaiama Declaration"[22] of 1998 asserts that:

> "The political crisis in Nigeria is mainly about the struggle for the control of oil mineral resources which account for over 80% of GDP, 95% of national budget and 90% of foreign exchange earnings. From which, 65%, 75% and 70% respectively are derived from within the Ijaw nation . . . the violence in Ijawland and

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16 See *Angola Country Economic Memorandum: Oil, Broad-Based Growth, and Equity* World Bank, October 2, 2006, Report No. 35362-AO.

17 See, for example, http://www.hrw.org/english/docs/2004/01/12/angola6925.htm

19 See *Nigerian militants win oil drilling licence*, Financial Times, May 19 2006

21 Stakeholder Democracy Network Newswire - *News and analysis direct from the Niger Delta* - June 2008

22 http://ijawcenter.com/kaiama_declaration.html

other parts of the Niger Delta area, sometimes manifesting in intra- and inter-ethnic conflicts are sponsored by the State and transnational oil companies to keep the communities of the Niger Delta area divided, weak and distracted from the causes of their problems . . . We call on all Ijaws to remain true to their Ijawness and to work for the total liberation of our people. You have no other true home but that which is in Ijawland."

In cases like this, as this statement illustrates, citizenship itself is compromised, as the section below explains.

Current and long-standing proposals for change in Nigeria – such as re-jigging the allocation of revenues at different political levels and tinkering with "derivation" clauses that decide how much money is allocated locally generally miss the point. Even if it were possible to "solve" the problem of the optimum resource allocation between different sub-national units (which is not possible; none of the units' representatives have ever declared themselves happy with their share even after attempts have been made to change the system,) the bickering between factions will then take place at the sub-sub-national political and administrative levels below that.

2.1 Fragmentation and conflict, corruption and authoritarianism.

It is obvious how this competition between factions for access to resources, and the consequent political and social fragmentation, can and do act as powerful drivers of overt conflict: civil wars, secessionist movements (such as the long-running secessionist movement in gas-rich Aceh in Indonesia, or in Angola's oil-rich Cabinda enclave,) and so on are all intrinsically linked to this fragmentation.

The links between fragmentation, on the one hand, and corruption and authoritarianism on the other, are less immediately obvious, but are no less powerful.

What is corruption? It involves, at heart, the promotion of personal or factional interests at the expense of the wider interest (or the national interest.) One of the ultimate *raisons d'être* of governments is to manage competing interests. As the FT columnist Martin Wolf put it: "In a society when everyone cheats and takes or pays bribes,there is little incentive not to join in. Government is a monopoly for good reason. Competing bandits are bad news." This is what mineral revenues do: they create "competing bandits" (and give them the wealth to increase their powers) – and this fatally undermines good governance.

Another aspect of the mineral-fueled factionalisation involves a loss of social trust. The collapse of a nation like Nigeria into widespread corruption is analogous to the collapse of a well-ordered queue and the ensuing scramble to get to the front: the problem is that people have lost faith in each other, and in the system. This is a systemic problem: enlightened leadership alone, or enforcement measures, will not readily solve it.

In short, mineral-dependent economies are rather like the queue; "normal" economies are not. In mineral-rich countries, those who are not able to "get to the front of the queue" – feel a strong sense of alienation and exclusion: this helps explain why so many citizens in the oil zones complain or feel such a strong sense of lack of citizenship. I have already remarked, in the case of Nigeria's multi-ethnic and oil-rich Niger Delta:

> This is all about belonging, or citizenship. As Ijaws, Ogonis, Itsekiris, and others trumpet their identities and claims to land, the very idea of Nigerian citizenship shrivels, leaving—like the cracks that appear in a lake bed when the water recedes—a fractured landscape.[23]

Rulers in oil-dependent states wishing to stay in power deal with this fragmentation in two main ways. One way is to use divide-and rule politics and carefully to deploy resource-based patronage (buying off restive factions by allocating resources or permissions to them – which is tantamount to corruption). The other way to sew up a fragmented political system, which is usually used in tandem with the first, is to wield an iron fist: through greater authoritarianism. If factions are restive, they are crushed – and natural resource windfalls pay for the armies, paramilitary forces and intelligence services that help the rulers do this. Countries which are already signicantly split along regional, ethnic or other lines fare especially badly when confronted with an inflow of easy oil money. Oil-rich Iraq, divided between Shias, Sunnis, Kurds (to mention just the largest groups) was, and remains, a prime candidate for authoritarian rule. Saddam was so brutal partly as a result of his own innate personality – but Iraq's oil wealth forcefully brought out his most brutal traits. Future Iraqi leaders, to assert control, may have to be brutal to suppress the factional competition for Iraq's oil resources.

The above analysis shows us how conflict, corruption and general social and political dysfunction, and authoritarianism – and the poverty that emerges as a result of these ills – can all be sourced back to this original problem of fragmentation. They are different manifestations of the same dynamic, which acquires a systemic character.

3. Tax and accountability: introduction

As mentioned above, taxation is a central factor in the Resource Curse. In mineral-dependent and mineral-rich nations, rulers tax the extractive companies, and can consequently ignore their citizens. This bypasses the healthy relationships of bargaining and accountability, and the institution-building stimulus provided by the imperative to collect taxes from a citizenry.

To understand this better, it helps to see what happens in "normal" countries not dependent on natural resources. Students of European and American history have long known about the beneficial effects on taxation on governance, and many students of history are aware of the phrase "no taxation without representation" used by American colonists resisting British oversight: they did not want to pay taxes if they were not represented politically. It is only recently that development theorists have seriously

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[23] Author's book *Poisoned Wells: the Dirty Politics of African Oil*, Palgrave MacMillan, 2007

started investigating the role of taxation in improving governance in modern developing countries. As a new book on the subject[24] explains:

"Taxation is the new frontier for those concerned with state-building in developing countries. The political importance of taxation extends beyond the raising of revenue. We argue in this book that taxation may play the central role in building and sustaining the power of states, and shaping their ties to society. The state-building role of taxation can be seen in two principal areas: the rise of a social contract based on bargaining around tax, and the institution-building stimulus provided by the revenue imperative. Progress in the first area may foster representative democracy. Progress in the second area strengthens state capacity. Both have the potential to bolster the legitimacy of the state and enhance accountability between the state and its citizens. . . . This idea is largely missing from the new scholarship on state-building. It is also largely missing from the practical concerns of those working in the aid community. The lack of attention to the relationship between revenue-raising and governance is surprising, especially given the long-standing linkage between taxation and governance assumed by students of European and American history."

Direct tax relationships, fostering bargaining and accountability, are essential components for forming consensus in a nation: this forming and management of consensus through tax is a key part of what repairs the fragmentation that would otherwise occur when the state allocates resources. A small number of resource-rich nations such as Botswana (which grew faster than the "Asian Tigers" for many years) and Indonesia have managed to escape the "Resource Curse." One of the things they appear to have had in common is a "shared political consensus" for growth. As one authoritative analysis of the few winners put it, regarding Botswana:

"a tradition of consensual politics favoured pluralism."[26]

Another analysis said this:

Botswana's population was ... "small and largely homogeneous and cohesive" . . . . both the political and bureaucratic elites acquired a "development orientation" . . . . At the same time, Botswana's consensual democracy showed a very high level of transparency in public revenue acquisition and disposal while corruption remained well below the levels common in many other developing countries.[27]

The latter study described two essential components for the "developmental state": an ideological component (when the ruling elite adopt "developmentalism" as their prime objective) and a structural component, requiring "a strong state which can resist pressure

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[24] *Taxation and State-Building in Developing Countries: Capacity and Consent*, edited by Deborah Braütigam, Odd-Helge Fjeldstad and Mick Moore, Cambridge University Press, 2008. Also see "How tax affects governance" by Mick Moore and Nardia Simpson, Tax Justice Focus, second quarter 2007 (volume 3 issue 2.) The Tax Justice Network website has a section providing further links, here: http://www.taxjustice.net/cms/front_content.php?idcat=130

[26] *Political Economy of African Mineral Revenue Deployment: Angola, Botswana, Nigeria and Zambia Compared*, Richard Auty, June 16, 2008, p4

[27] See *Resource impact: a curse or a blessing?* By Professor Paul Stevens, University of Dundee, April 2003, http://www.dundee.ac.uk/cepmlp/journal/html/Vol14/Vol14_1.pdf

from strong, short-sighted private interests and/or some form of "social anchor" which restrains any temptation to use its autonomy in a predatory manner. This analysis would put Botswana in the same category, analytically, as Norway (even if this comparison seems odd:) they are both countries that already have strong institutions of the kind that can counter the fragmentation. Other countries do not have such pre-conditions for successful management of natural resource wealth, and as academic studies have indicated, there is no obvious way to create these pre-conditions.

4. Reasons why traditional remedies have fared so badly.

It is important to examine the current prescriptions for tackling the Resource Curse. The main strategies[28] proposed by western development institutions can be summarised:

- Economic diversification
- Oil funds
- Transparency

In practice, these strategies have all been effective – but mostly in countries such as Norway or Britain where strong and effective political governance has already been developed. In mineral-rich developing nations in Africa and elsewhere, the results from these initiatives have been rather meagre. To cite just one recent example: best-practice oil legislation (including an oil fund mechanism) for São Tomé e Principe, designed by a team led by Prof Jeffrey Sachs' Earth Institute at Columbia University and supported by international institutions such as the World Bank, was soon overwhelmed by reality and the work of malign and shadowy political forces from the outset – and that was when the forces were relatively weak: even before any commercial oil discovery had been made.[29]

The essential reason for this generally poor record of western recipes for reform is that these proposals all involve a measure of circular reasoning: it is only politically feasible to enact these proposals when countries are already well governed. It has not been possible to implement them seriously in countries where these prerequisites for success are absent. Let us examine these proposals one by one.

Economic diversification is an excellent idea, and the rulers of mineral-rich states around the world routinely call for this. The essential problem is this: the Resource Curse tends to "attack" other sectors of the economy. For example, between 1975 and 1978 alone the total area under active agricultural cultivation in Nigeria fell by over 40 percent[30]. The over 99 percent export share of oil and diamonds in Angola, described in

[28] There are many others, such as forward planning, or narrow technical recipes for improvement, or special barter arrangements such as the oil-for-infrastructure deals used by China in Angola; these three are the main ones widely accepted to date.
[29] The author's book *Poisoned Wells: the Dirty Politics of African Oil*, Palgrave MacMillan, 2007 describes the politics of these processes in Chapter 8.
[30] *Crippled Giant: Nigeria since Independence*, Eghosa Osaghae, Hurst & Co., 1998

section 1 above, is another example. Politicians want to diversify and routinely make proclamations of this desier - but mineral dependence tends to prevent this, especially in already badly governed countries.

Oil funds are another good idea which seem to have worked well in places like Norway or Alaska: they enable countries to prevent sudden windfalls overwhelming local absorption capacity and they smooth revenue volatility; they also keep harmful mineral rents out of the economy, and they enable countries to save for the future when the mineral revenues run out. But such funds have not been implemented successfully in, say, Africa. The reason is fairly obvious: oil funds constitute a large and tempting pot of money, tempting for the politicians. Because political factions and groups in fragmented political structures do not trust each other to resist temptation, they scheme constantly to get their hands on such funds – often getting hold of them even before the revenues get a chance to be paid into a fund. Norway and Alaska, by paying into huge and growing funds, exercise remarkable acts of national self-restraint by not constantly dipping into the pots: badly governed countries with fractured politics and factions constantly scrambling for resources are simply not capable of such acts of collective self-restraint, even if the policy-makers start out with good intentions. Gabon, for example, set up a Fund for Future Generations (FFG) and set up fiscal rules to guarantee accumulation of reserves; a recent IMF analysis estimated that the fund contained just 8.8 percent of the total it should have held, had the fiscal rules been followed.[31] (This is not an especially egregious example; it was chosen here because it is quite well documented.)

Much attention has been paid to the importance of **transparency**: providing citizens with the information to allow them to "call their governments to account." This is another excellent idea, but despite the effort put into initiatives such as the Extractive Industries Transparency Initiative (EITI) the results on the ground have been, while positive, rather limited so far. A total of 23 mineral-rich countries have become EITI candidate countries; none have progressed to being "implementing countries" though some presumably will in due course. There has been a significant improvement in transparency in a number of countries under EITI, though from a very low base in most cases. But there are some fundamental problems with it.

First, it is a voluntary intiative, and many of the countries for which transparency is most important – such as all the Middle Eastern countries – have spurned it.[32]

Next, one of the big problems related to this relative failure is that EITI has not sufficiently taken into account the international dimensions of transparency have. This has been discussed in detail by the Tax Justice Network[33] and will not detain us unduly

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[31] *Natural-Resource Depletion, Habit Formation, and Sustainable Fiscal Policy: Lessons from Gabon*, IMF Working Paper WP/06/193, August 2006

[32] A map of EITI countries is available here: http://eitransparency.org/implementingcountries

[33] A general treatment of the corruption and transparency debates can be found here: http://www.taxjustice.net/cms/front_content.php?idcat=100 and I and TJN senior adviser

here, except to note that in summary these schemes have been voluntary in nature, when in fact more international regulation and mandatory schemes are required to give transparency teeth.

Another problem with transparency is that calling on countries like Equatorial Guinea to be more transparent with their mineral revenues (in order to allow their citizens to "call their governments to account") is a bit like calling on badly-governed countries to govern themselves better: it is rather tautological. Even if incentives are provided for them to do so, they will often try to pay only lip service to the proposals, while finding ways to conduct business as usual. Secrecy is intrinsic to mineral-rich states: when narrow factions scramble and struggle against each other, information is a powerful weapon at their disposal in their constant struggles with each other; so they work hard to ensure others do not get access to their information.

Another profound failure is that where new data has been provided, civil societies in Africa and elsewhere have so far done a poor job in using it to "call their governments to account," even in areas where transparency has improved. There are no clear examples, it seems, where publication of mineral revenues and discrepancies has led to mass public protests by locals angered at obvious theft. Despite significant publication of detailed data in Nigeria, there has been relatively little reaction from civil society and, crucially, there is no obvious sign (though it is hard to measure these things precisely) that the huge and widespread corruption and poverty in the country has been meaningfully curbed. It is also uncomfortable to note that some of the (few) mineral-rich countries that appear to have dodged the curse – such as Malaysia and Indonesia – have operated with relatively poor transparency.)[34]

In the countries and cases where action from civil society has happened, it has tended to come only in limited ways and in limited forums, and often results from donor-supported projects where donors have specifically asked for them to undertake this kind of action. There is nothing wrong with these donor-manufactured transparency initiatives: but they are *not nearly* as effective as broad grassroots movements would be.

In other words: the considerable attention paid to EITI is to a very large degree being heard in the international arena, from donors and in western newspapers and other forums; but the noises on the ground – where it really matters – have been more muted.

The lack of real civil society take-up is partly because of the sense of exclusion and loss of citizenship, described above. When there is no sense of shared nationhood, but instead a fractured and fissured political landscape, it has been very hard indeed for citizens to mobilise on a common platform to articulate their demands for rulers to be held to

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Richard Murphy have co-written a specific critique of EITI: see *African graft is a global responsibility*, by Richard Murphy and Nicholas Shaxson, Financial Times, June 1 2007

[34] See Paul Stevens' intervention in this World Bank forum: http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2004/08/26/000112742_20040826095443/Rendered/INDEX/296760Petroleu1ue0ESMAP0tech0no1051.txt

account. If they try, the politics of patronage, or repression, are easily deployed to stop them. In short, fragmentation also gets in the way of effective civil society, undermining transparency initiatives.

Tax is another fundamental reason why civil society has been so flaccid in so many of these countries. As mentioned above: direct taxation (along with democracy – which tends to be undermined in mineral-rich states) is perhaps the most important lever that citizens have enabling them to call their governments to account.[35] Transparency certainly helps, but it has not proven to be decisive: it does not overturn this fundamental tax relationship; it still leaves governments taxing mineral companies, not citizens, leaving rulers with the levers of power.

It is also worth looking at another academic analysis proposing direct distribution, which said this about transparency:

"While natural resource rents seem to have corrosive effects on governance, tax revenues do not.. . . human beings are prone to care much more strongly about money that has passed through their hands (such as income taxes) than money that they simply never see (such as wasted or diverted natural resource rents). . . . .the capacity of citizens to exert pressure on their government varies with the amount of information available to them. People know how much they personally pay in taxes (at least direct taxes); they normally do not know the magnitude of government revenues from natural resource rents. Moreover, the magnitude of per capita tax burdens is easily understood in terms of the ordinary citizen's everyday economic experience; whereas aggregate government budget numbers are much more dificult to grasp,"[36]

In other words, this proposal – direct distribution - would automatically and immediately deliver a dramatic improvement in transparency, along with powerful new incentives for people to hold their rulers to account. This is now discussed in detail.

5. Direct distribution: a different solution.

The difficulties outlined above that afflict the conventional strategies for fighting the Resource Curse lead to a conclusion that any answer that seeks to change the harmful Resource Curse governance dynamics very profoundly must address two things. First, it must provide a solution to the political fragmentation that is the origin of some of the main symptoms of the Resource Curse. Second, it must directly address, indeed overturn, the taxation relationships in mineral-rich states which bypass the citizens and leave all the main levers of political power in the rulers' hands.

Direct distribution decisively addresses both problems. If enacted in a pure form, it would directly address the fragmentation: revenue payments would no longer be analogous to

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[35] For more information on this, see http://www.taxjustice.net/cms/front_content.php?idcat=130 and associated links

[36] *Natural Wealth Accounts: A Proposal for Alleviating the Natural Resource Curse*, by Martin E. Sandbu, University of Pennsylvania, Philadelphia, World Development Vol. 34, No. 7, pp. 1153–1170, 2006

people in a queue, but would be widely and equally distributed (wide and equal distribution are essential: targeted distributions would not work since they raise the crucial political question of who is "in" and "out" – the big question that ultimately drives the fragmentation.) Once the direct distribution happens, the incentives for citizens to look upwards for their income (allocations and permissions from their superiors) are transformed into incentives to look sideways: to co-operate with each other. The route to increasing one's income will be through trade and business and other activities: to set up and use the mobile telephone companies, the hairdressers, and all the other important elements of a successful economy. Many new (and taxable) businesses would grow to service the needs of the newly wealthier population. And, crucially, the tax relationships would be overturned, requiring the government to bargain with its people to receive its revenues.

What is more, civil society would no longer be so fragmented but would have broad, shared interests again – the essential prerequisites for strong grassroots action. (Civil society would also be strongly empowered by the wealth effect of redistribution: power follows the money.)

Added to these very large benefits would be the likelihood that the incentive for most forms of conflict would evaporate. Imagine a thought experiment involving Angola's 1991 Bicesse peace agreement. In the real world, UNITA rebel leader Jonas Savimbi rejected the results of the 1992 elections that followed the peace agreement, once electoral defeat for him became apparent and he returned to fight what the United Nations subsequently described as "the worst war in the world." However, had direct distribution been enacted, even if Savimbi had still wanted to return to war, he would not have been able to raise an army – participating soldiers would cut themselves off from their meal tickets. This is just an untestable thought experiment: but there is no doubt that it would drastically reduce turmoil. It would transform the dynamics of criminalised mineral-based conflicts that plague oil-rich areas such as the Niger Delta: these conflicts are organised to a significant degree by mainstream politicians effectively hiring militias to bolster their political positions – and hence their claims on larger shares of the national wealth.[37] While feelings of separatism in mineral-rich regions would not necessarily disappear, these conflicts would not become criminalised in the same ways so would be far easier to manage.

It is worth adding that western governments and companies should have very strong incentives for the getting such a scheme up and running in some places, for at least three main reasons. **First**, some oil zones, notably Nigeria's Niger Delta, are plagued by militant unrest which has significantly disrupted production. Such a scheme would remove the main causes of the unrest, and help stabilise world oil supplies. **Second,** western oil companies bidding on new acreage in oil zones are increasingly facing competition from Chinese and other Asian national and private oil companies, which tend

[37] Such as widely documented fights between Alhaji Dokubo-Asari and Ateke Tom (and others) in the Niger Delta at the behest of local politicians in the run-up to the 2003 elections.

to be rather less squeamish than them about bribery and generally corrupt behaviour (though this is not to absolve the Western companies, of course.) This proposal, by radically disrupting the incentives for corruption and altering the governance climate, would enable better-managed companies to compete more easily on the basis of quality, rather than on who is able to pay the biggest bribe. A **third** intriguing incentive (which requires more research) is that that distributing money directly to citizens might reduce some of these countries' massive accumulation of foreign exchange reserves in oil funds and elsewhere, thus reducing their contribution to future global financial imbalances.

6. How it could be done

While it has proved relatively easy to implement this in developed nations (as it is done, for example, in Alaska, where it is wildly popular) the scheme must be made to work in badly governed countries in the developing world. I will not offer any detailed prescriptions for how it might be done, but some broad ideas only. Part of the purpose of this paper is to call for further research into how this might be done, including identifying where might be a good place to start.

The **purest form** of this proposal would involve the distribution of *all* mineral revenues – royalties, profit oil shares and other concessionaire receipts, taxes on corporate profits, signature and other bonus payments and so on – directly and equally to a nation's citizens. The distribution would not be carried out by the government itself (otherwise its officials might easily help themselves to revenues before they reach the citizens.) Instead, the revenues would be paid directly from the oil sector and distributed to the people by a third party – such as some trusted international organisation like a specialised United Nations or World Bank unit (which already have legitimacy and capacity in organising or helping organise large-scale events in poor countries such as mass vaccination programmes, national elections and the like.) The government would have no direct access to the revenue streams: it would get its revenues as a result of having to set up appropriate direct taxation systems. Several variants on this system could be considered; they are beyond the scope of this paper.[38]

As mentioned above, this proposal faces two main difficulties: technical implementation challenges, and political resistance.

6.1 The technical difficulties

The technical difficulties with implementing this are unlikely to be substantially greater than organising national elections (with associated voters' rolls, oversight mechanisms etc.). A key difference would be this: participating populations – especially in corrupted, rather authoritarian mineral-dependent states where people may be apathetic about

[38] See, for example, *Natural Wealth Accounts: A Proposal for Alleviating the Natural Resource Curse*, by Martin E. Sandbu, University of Pennsylvania, Philadelphia, World Development Vol. 34, No. 7, pp. 1153–1170, 2006, for some additional possibilities.

democratic processes because they feel the the deck is stacked so firmly against them – are likely to be unusually, perhaps even wildly, enthusiastic in the case of direct distribution (as is the case of Alaska, where a limited version of this has been introduced, as illustrated by this comment: "Any (Alaskan) politician who even suggests considering a policy that might adversely impact the size of the annual distribution had best look for another career.")

For those worried about whether the governments of badly governed countries can implement this – avoiding the temptation of diverting all the money - this depends on how it is implemented. As already indicated, a pure version of this proposal would see the governments not involved at all: all oil revenues would be distributed though a third party (such as the World Bank or a special United Nations body, for example), receiving the money directly from the mineral extraction companies and then distributing them directly. The government and its officials are prevented from appropriating the money and must instead negotiate with the citizenry for its revenues. It is the divisiveness of traditional mineral revenue spending, as explained above, that is the direct cause of so much corruption; this approach would introduce an alternative (and self-sustaining) political climate that would be far more conducive to the conduct of such an exercise.

A less pure version of this proposal would see governments receiving a share of the mineral revenues directly, while another share is allocated to the people. This would be less effective, for while it would indeed transfer extra power to people away from their rulers, the pernicious fragmenting and other dynamics that currently blight these states would remain potent. Another less pure version might be the implementation of such a scheme on a sub-national level. (This might then raise political questions from other members of a mineral-rich nation, however, although it may still be a better solution for somewhere like the Niger Delta, if it could ever be implemented there.) Yet another less pure version might involve the slow and gradual introduction of this, where the share of directly distributed revenues might rise gradually over time, as the share of direct government revenue falls.

It is also not the purpose of this paper to examine the details of how to overcome the technical difficulties; instead its chief purpose in this respect is to argue that more detailed research is now needed to establish where and how this might successfully be done. Factors to consider might include:

- Which countries could this be made to work in from a purely technical point of view, given expected mineral revenues per capita, weighed up against expected transaction costs of such an exercise.

- Which lessons might be learned from existing successful schemes in the rich world, such as in Alaska?

- Which schemes in developing countries might have relevance for informing such an exercise? For example, recent research and practice in the field of direct cash transfers is a fast-growing area in the development field; this may have lessons for a direct distribution exercise. Complex electoral registration processes in poor countries might provide important insights. Etcetera.

- Examination of appropriate banking arrangements, technology, such as personal recognition software (perhaps akin to what is used in elections elsewhere) to establish a reliable participants' roll. Could money transfers via mobile telephony be part of such a scheme.

- What are the requirements for legislation and legislative reform and preparations?

- What are the local political and economic conditions in possible candidate countries? What factors might militate against this?

- How such an exercise might be combined with traditional Resource-Curse remedies. For example, how, if at all, could this be combined with an oil fund approach?

- Which trustworthy global (or other) institution might be best-placed to take this on?

The fact is that there is currently no serious research out there, so if a politician or group in a mineral-dependent country wanted to try implementing this, it would have no ready source of technical support or expertise. It is <u>essential</u> now to create the support networks that would give voters and politicians the possibility of making this choice for their countries.

As noted, many of the world's development institutions may be deterred from getting involved in such a radical and politically explosive proposal, for fear of antagonising politicians in producer governments. It would therefore seem that independent entities – such as the Tax Justice Network, and/or or academic institutions and think tanks – would currently be best placed to help push this proposal forwards, at least at an early stage.

6.2 The political difficulties

Some of the opponents of this proposal have suggested that this raises severe problems of sovereignty, by taking revenues out of the hands of sovereign governments. This is fairly easily rebuffed from a technical and academic point of view: according to modern political theory, sovereignty is generally seen as being vested in "the people," (for example, Angola's oil law 13/78 states that Angola's oil belongs to "the Angolan people"); and generally the government is then chosen as "agent" to represent the people, who are the "principal". (In Saudi Arabia, however, the symbolic transfer of sovereignty from the King to the people never happened.)

This is a classic case of the principal-agent problem. As George Soros put it:

The rulers "can only obtain (oil and mining concessions) from the rulers of the countries, but the rulers are not the principals. They are the agents of the people. The rulers get their rewards from the companies, not from the people whose interests they are supposed to safeguard. They have much greater incentives to remain in power than the rulers of resource-poor countries and they have greater financial means at their disposal. That is why resource-rich countries are less democratic and often fall into the hands of repressive rulers. The countries concerned are also more prone to civil strife. This is the key agency problem and the primary source of the revenue curse."

An initial observation on this is that direct-distribution solution would directly, and decisively, address the principal-agent problem. The philosophical dimensions of this aspect of the proposal are certainly interesting and not entirely clear-cut, but if such a scheme could be implemented and shown to be successful, the philosophical questions would presumably be overcome fairly fast.

But that question is not the same as the question of political will. Rulers, of course, would have extremely strong incentives to resist the proposal for direct distribution, which would transfer agency (and massive wealth) away from them and to ordinary people.

As a result, it is inconceivable to think that this could be implemented <u>immediately</u> in most, and perhaps all, mineral-rich developing countries. A longer-term strategic approach to the problem, however, looks far more promising.

First, it is my belief, based on many years of interviews and on-the-ground observation in Western Africa's oil zones, that some oil-rich African leaders and many of their senior officials do harbour genuine wishes – albeit often mixed with all kinds of other more personalised interests which directly counteract these wishes - to see their countries develop (the fact that they may *also* be interested in self-enrichment does not negate this.) Some observers may well dismiss this, seeing these regions simply as a sea of corruption and avarice. This is wrong, for these leaders' motivations are far more complex than that. The reason that they behave in ways that appear to harm their countries is often that they are powerfully constrained by the dynamics of mineral revenues (and aid money) in a context of fragmented and fragmenting societies without significant social trust. So it seems likely that at least some politicians would ultimately support such a scheme in any mineral-rich country, if it looked like it was going to work.

It is therefore necessary to identify possible entry points where such a scheme might be introduced. The best approach is to get it up and running somewhere, show that it can work, and then use this success to spread the idea. Once it has been shown to work somewhere, then other countries (and especially ordinary citizens) would be far more receptive to the proposal. It might, even in the absence of a direct distribution scheme, provoke greater calls for accountabilty from citizens of their mineral-rich rulers, when they see what has happened in other countries and what may be possible at home. Civil society in such countries tends would not be heavily divided on this issue.

It is important to think of this proposal as a process, which may have several possible entry points. Here are some examples.

- One entry point would be to select a country where mineral reserves have been discovered but **first production is still several years away**. This way, the institutional dynamics and entrenched vested interests will not yet have established themselves. Ghana or Uganda, where oil reserves have been found but where production is still a few years away) might be possible places to start (but might not; much further research would be needed first.)

- Another entry point might be where an **opposition leader**, standing in elections, **makes this a policy platform** in an election campaign. [39]

- A **president leaving office** might have an incentive to introduce such scheme ahead of his departure to leave a legacy of widespread popularity.

- A militant group in an important oil zone (such as the Movement for the Emancipation for the Niger Delta, or MEND) might introduce such a proposal as part of a **negotiated solution to conflict** with a government, leading to this, as part of a negotiated solution to a serious military crisis. There is currently no sign of such a demand anywhere, but if a working example could be put in place, such demands would presumably emerge.

- A **working example** could, theoretically, be introduced initially in a nation where the money is not from mineral revenues, but from donors. This would be expensive, but perhaps feasible in a country where the population is small enough.

- It might be introduced in a country where there is a "**clean slate**." Iraq is the obvious example, but a country where a hated government has just been overthrown might be another. In a widely read *Foreign Affairs* article in 2004, called *Saving Iraq from its Oil*[40], the economists Nancy Birdsall and Arvind Subramanian advocated direct distribution for Iraq, as a unique chance. A large impetus for the subsequent civil war in Iraq (and the previous period of extreme authoritarianism) came from struggles over control over the state and its oil revenue, with endless discussions after the invasion about power sharing – which is the key to determining how the national oil "cake" is divided up. Had direct distribution been fully implemented, the most poisonous element of the power-sharing question would have been entirely removed – and the civil war would probably not have happened. Even if the Iraqi government had considered this option, they would have had little experience, research and support to work with.

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[39] The author, soon after publishing an article on direct distribution in *International Affairs* was once contacted by an opposition politician in Latin America, in an e-mail proposing working together on this, but this never evolved into anything. I do not have permission to reveal the politician's identity (or country;) the e-mail contact appears to have stopped.

[40] *Saving Iraq From Its Oil* by Nancy Birdsall and Arvind Subramanian Foreign Affairs, July/August 2004

Such a body of research should now be created.

- A **change in a major oil licence** in a conflicted area might introduce an opening for a limited version of this. As a report from a close observer of Niger Delta politics put it, following news in June 2008 that Shell is to be replaced by another operator in oil-rich Ogoniland in the Niger Delta:

  > "there is a rare opportunity for the Federal Government and a new operator to chart genuinely transformative approaches on operations and relationships with communities. It will require a commitment on the part of government to appoint a truly "best practice" operator with innovative ideas for engaging and involving communities."[41]

There are others. Once an entry point has been achieved and a working version is running successfully, the international climate of opinion about this proposal would shift in its favour. This would help sell the proposal in other countries, and would build pressure within civil societies for similar treatment.

The final argument against the "it is too difficult" objections is one that TJN has made with respect to international co-operation on tax: this is a bit like opposing the fight against drugs smuggling because it is too hard. On the contrary, the fact that it is hard is a good reason to try all the harder.

This section has dealth with the argument that Direct Distribution is too difficult. The other, lesser, objections, are dealt with below.

7. Countering the counter-arguments.

So many objections have been raised to the notion of direct distribution, whenever the proposal has raised its head, that it has never made serious headway. This section seeks to (briefly) examine each main objection, in turn, [42] beyond the main objections already addressed in Section 6 above and in the introduction. Some of the objections need detailed answers for which there is no space here. Other possible objections exist but are probably less forceful, and so are not dealt with here.

1. **Such a scheme would be prone to corruption and leakages.**
   The risk exists, of course, but to suggest that it could be worse than the corruption and leakage currently occuring in places like Nigeria or Equatorial Guinea is

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[41] Stakeholder Democracy Network Newswire - *news and analysis direct from the Niger Delta* - June 2008

[42] Sandbu, in *Natural Wealth Accounts: A Proposal for Alleviating the Natural Resource Curse,* discusses a set of objections on pp1164-1166. I presented a slightly different list on pages 1137-1139 of my article *Oil, corruption and the resource curse,* International Affairs, Vol. 83 number 6, November 2007, which also discussed many of the issues in this article.

[44] See, for example, http://www.brettonwoodsproject.org/art-561926

ridiculous. It would be much less, for several reasons. The involvement of an outside and trustworthy implementing partner would be one factor. Perhaps more pertinently, since the proposal directly and decisively addresses the climate of corruption and the weakness of civil society oversight, as explained above, the risks and challenges would be severely curtailed. (Indeed, poor and very badly governed countries do already make mass payments to individuals, sometimes in their hundreds of thousands, when they pay civil service salaries. These payments, while imperfect, tend to be among the best-protected payments of all in a financial system – because the political consequences of non-payment are so dire. Salaries tend to get paid (although leakages do occur). Other, related, schemes, can be made to work. Donors, for example, are now finding success with direct cash transfer schemes. Many private banks also lose little to corruption, even in the worst-governed places.

2. **The social rate of return to investment in public goods and targeted social spending is much greater and more equitable than the private rate of return on consumption by distributing oil revenues.**
   This is mistaken for several reasons. First, under this proposal the government still gets its revenues, as explained above: with the difference that accountability is transformed. Second, this is not about "efficiency" and "rate of return" – witness Angola's giant oil-fired budgets and appalling poverty – but fundamentally about accountability. Third, it is a recurring mistake by the IMF that revenue saved by greater "efficiencies" will be channeled into "targeted social spending" – this, as is often observed,[44] regularly does not happen in badly governed countries. As an IMF paper put it: "a number of studies that find discouraging rates of returns from public investments and only a limited effect on non-oil growth."[45] Angola's targeted social spending projects – notably subsidised exchange rates until 1999/2000, then subsidised water and energy – ended up benefiting the richest five percent of the population. This pattern is common across developing resource-rich nations.[46] (In countries where governance is good enough, targeted approaches may be possible, as a variant of this scheme. The success of the Progresa and Oportunidades projects in Mexico, where cash transfers are made on condition of proper school attendance and health checks have been shown to have significant beneficial effects.)
3. **This is a kind of privatisation: privatisation is the wrong recipe.**
   This is emphatically <u>not</u> a form of privatisation, or anything like it. Direct distribution is about passing financial flows, not organisational structures, into the private sector. To illustrate the difference: a problem with privatisation of oil sector assets in the past has been that these assets have tended to become

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[45] *Old Curses, New Approaches? Fiscal Benchmarks for Oil-Producing Countries in Sub-Saharan Africa*, IMF working paper WP/07/107, May 2007.

[46] Richard Auty, for example, said of Angolan public expenditure "it is also pro-wealthy because rent reduces taxation (of the rich) and subsidizes consumption of public services, ostensibly to help the poor, but richer Angolans consume most of the subsidised water and energy" in *Political Economy of African Mineral Revenue Deployment: Angola, Botswana, Nigeria and Zambia Compared*, Richard Auty, June 16, 2008

monopolised by a few vested interests, like the Russian oligarchs. This proposal, if properly implemented, would not allow anyone to accumulate claims on future revenue streams beyond their single-citizen allocation. Another related misconception is that Direct Distribution would strip the government of badly needed funds. This is not so, as discussed in Section 1 above.

4. **It will not solve the Dutch Disease or revenue volatility: an oil fund would be better**
   This may or may not be correct, from a technical point of view, although there is no reason to believe that it would exacerbate it. However, the dramatic welfare effects achieved would, however, strongly and directly counteract the negative and very real Dutch Disease effects (leading expansion of a mineral enclave that produces few jobs and the contraction of mass-employment sectors like manufacturing or agriculture). Importantly, however, this proposal represents a radical democratisation of decision-making – notably the key economic question of what should be saved and what should be spent: a democratisation of the oil fund policy, as it were. Moreover, much research has been done on the "wisdom of crowds" thesis[47] supporting the notion that groups on people on aggregate make better decisions than the group's smartest member.
5. **This will not solve separatist claims for a greater share of local oil revenues.**
   While locals in mineral-rich regions will still feel grievances about their distributional shares, this proposal would draw the poison from this. If implemented properly, direct distribution would remove the kinds of criminalised politics and networks that feed insurrections in the Niger Delta and elsewhere.
6. **Local protection rackets will emerge to appropriate the money.**
   This assertion has been made against direct distribution in the past; it indicates a misunderstanding of the nature of the problem. Simply put, protection rackets target companies or institutions (such as local government bodies – in other words, concentrated sources of revenue and wealth) but they are generally far less effective against large populations with widely dispersed wealth.
7. **It will foster a culture of dependence**
   One difficulty facing welfare states in developed nations is that benefits tend to fall as alternative income rises, creating disincentives to work. This is not the case with direct distribution, for the distributed income will be unchanged when someone earns additional income. It will instead change the direction of people's incentives: away from the vertical relationships of dependence on government and its mineral wealth, and towards horizontal relationships with the nation's newly wealthier fellow citizens.
8. **This is like a negative income tax, which has been discredited.**
   There are similarities, but the differences are too great to make this a serious objection.
9. **Gatekeepers, such as in the ports or implementing banks, would appropriate the windfalls.**
   This is a risk, but as discussed in point 1 above, this happens already, and the

[47] Wikipedia has an informative entry:
http://en.wikipedia.org/wiki/The_Wisdom_of_Crowds

potential for gatekeepers to behave like this in an environment of better accountability and transparency would be sharply curtailed.

10. **People will just waste the money**
    There are plenty of anecdotes of payments being wasted: The Economist, for example, noted this in 2002 of a windfall from the Chad-Cameroon pipeline project:
    "The farmers squandered their windfall. One celebrated by taking a bath in beer. Another left his mud hut and went to stay in a four-star hotel in the capital, Ndjamena, for a couple of weeks. Others took several more wives." [48]
    These are just anecdotes. Individuals will on aggregate make far better decisions, as outlined in point four above, and for all the reasons outlined in this paper this is a far better approach, on so many levels. As almost any current inhabitant in a mineral-dependent country would attest, politicians would manage the money far worse.
11. **It is just too radical and too outlandish to take seriously**
    Before Britain introduced the welfare state, the notion was panned as unworkable. It was quickly shown not to be so, and due to the success of early welfare states the notion spread fast, and widely, around the world. Direct distribution would replicate this.

The revolutionary nature of this proposal, and the potential for truly vast gains in human welfare and human security, mean that these casual dismissals that have been made verge on the irresponsible – in an environment where these objections have not been challenged. An important part of what needs to be done now is to address each of these objections properly in turn – and build up a body of work that explores them all in detail and maps a way forward.

8. Conclusion

The simplest reason for considering this proposal is that mineral-dependent countries like Nigeria are often in such a sorry state that it would be hard – very hard – to make matters any worse. In terms of political power, direct distribution would represent a massive transfer of power away from corrupt politicians to a country's citizenry: power will follow the money. It will also reverse the political and social fragmentation that is at the heart of the "governance" aspect of the Resource Curse, changing citizens' incentives away from vertical dependence towards horizontal co-operation. In economic terms, this proposal would represent a dramatic democratisation of decision-making and consequently dramatically improved governance. It would also, of course, have powerful welfare effects resulting from the massive transfer of wealth from rich to poor – and other associated benefits, such as the deepening of a participating country's financial system. Governments would still get their revenues – it would be reduced, but because of radically improved governance and accountability, the lost revenues would be more than countered by far better and more accountable spending.

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[48] *The Economist*, December 2003

The route to achieving this must be considered, as must the institution carrying it out. It is unlikely that it could be done in Nigeria today, for example: the vested interests against reform are too powerful. Instead, the route should be through an initial working example in an “easy” country, whose success can then be built on, contributing to a general international climate in policy-making circles that favours this proposal.

It is essential now that this proposal moves from the theoretical academic phase into a more active phase, where research and other work is carried out into how and where it might be implemented, so as to give mineral-rich countries’ citizens the choice to be able to implement Direct Distribution if they want. This choice does not yet exist. The time has come now to work out where and how it can be done, and to push the proposal forwards more actively.

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