Resource Impact: Oil, Development and Good Governance

In the view of classical development theory resource-abundant countries should benefit from the gift of nature by earning economic rents. The expansion of exports of the booming sector, engendered by new discoveries of mineral or hydrocarbon sites or price hikes at the world market, should result in increased saving rates and foreign exchange reserves. Hence the “dual gap” that has attracted much attention by development economists during the 1950ies and 1960ies, should have been overcome by these countries, providing them with the means to import capital goods and embark on a path towards industrialisation fuelled by a strong export sector. In contrast, the concern that natural wealth exerts an immiserating effect is also a recurring theme in development economics. It can be traced back to the Prebisch/Singer hypothesis of a secular comparative decrease of primary export prices incurring terms of trade losses to developing countries.

This pessimistic outlook gained momentum in the aftermath of the oil price hike in the 1970ies and early 1980ies. In most exporting countries ballooning export revenues did not uplift the overall economy. The first oil shock in the 1970’s shifted the focus of the “paradox of plenty” on oil exporting countries, caused by concern that large-scale revenues might even impair the development prospects of non-boom sectors. The symptoms were mainly attributed to “Dutch disease” (DD), triggered by real exchange appreciation and concomitant crowding out effects (see below). In the 1990ies, issues of governance and political economy received increasing attention, based on the observation that some oil exporters were able to dodge DD effects and to successfully promote national development. In accordance with general developments in economic theory (public choice, institutional economics), the macroeconomic mechanics of “Dutch Disease” were complemented, if not substituted, by subjects relating to policies and political economy.

The revival of interest in this subject during the last couple of years is owing to the fact that a number of countries in Asia and Africa, as e.g. Chad and Cameroon, are about to embark on oil and gas production on a relatively large scale. This development gave rise to concern of the international community, particularly of the IFIs, about the use and impact of the new revenues. International NGOs have raised serious concerns about the impact of oil and mineral dependence on poverty, violence, corruption and political freedom. They were successful in bringing the issue of resource curse to the attention of a much wider audience and launching international actions.

The following chapters will argue that (i) first and foremost policy response to DD impact and the quality of institutions determine the outcome of a resource boom, (ii) fiscal policy devices (rules, funds) can provide remedy only under conducive conditions, (iii) transparency initiatives of multilateral institutions go a long way toward ensuring such conditions, but fall short of turning the tide, and (iv) in the long run domestic constituencies committed to prudent resource revenue management are called for.

A Resource endowment and development performance

Besides lower overall growth rates, detrimental impacts allegedly impair the affected countries in different aspects, such as poverty rate and count, income distribution, education and human capital, quality of institutions, non-mineral and non-oil exports, domestic tradeables, savings and investment ratio, and the quality of macroeconomic policies. There are, indeed, indications that resource-dependant countries are performing worse in many, if not all aspects. Exporters of oil, gas and minerals have recorded a comparatively low performance with respect to income p.c., employment, poverty alleviation

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1 Measured by the ratio of resource to total exports and the ratio of resource revenues to total government revenues. Usually the benchmark is put at 25% for both ratios.
and distribution (Stevens 2003, Ross 2001, Sarraf and Jiwanji 2001). This observation has also been made for countries in possession of huge resources in comparison to population size, as e.g. Saudi Arabia. It is precisely this manifestation of resource curse that has raised the concern of international organisations and of the companies involved in the oil business as well, as they fear their image could be spoiled if they are associated with misery.

I Macroeconomics of Resource Curse: the Dutch Disease

Concern with economic repercussions of resource windfalls has passed through several stages since the first oil shock in the 1970ies. It was noticed that oil-exporting developing countries witnessed a decline of income and traditional export levels. The key explanation offered by economists put the focus on sectoral shifts which were considered detrimental to overall growth of the affected economies. They were supposed to be triggered by an appreciation of the real exchange rate which can be defined as price relationship of traded (exportable and importable goods) and non-traded goods (products produced and traded within the domestic sphere). Due to a significant accretion of windfall gains the relative scarcity of tradeables and non-tradeables is likely to change. The price of non-tradeables, the supply of which cannot be augmented by imports, will increase relative to the price of tradeable goods, thus enhancing factor incomes and employment incentives in the sector of non-tradeables. Ensuing resource shifts are the typical symptom of Dutch Disease which is characterised by shrinking import-substituting and (non-boom) export sectors and expanding sectors of non-tradeables. In the context of developing countries mainly agricultural exports were hit, but also infant industries geared to domestic markets. The Dutch Disease concept highlights the spill-over of the booming export sector on the rest of the economy, arguing that the net effect on growth tends to negative.

Although the potentially harmful crowding out effects of Dutch Disease is not disputed, doubts have been cast on the persuasiveness of their overall impact. Dutch Disease can be overturned by appropriate policies, but also be worsened through bad management of revenue resources. In the 1970ies Nigeria, like many other oil exporters, was diagnosed for Dutch Disease. Nigeria, however, manifested specific symptoms as the main non-tradeable sector, agricultural food production, suffered a persistent shrinkage of output and employment, whereas according to the theory of Dutch Disease it should have expanded (Corden 1984). The deviation was attributed to the Government’s spending focus on urban and industrial areas and projects, and the ensuing shift of labour and resources out of agricultural sectors (Collier 1988; Oesterdiekhoff 1990).

The empirical relevance of DD has been discussed ever since it’s gaining currency in development economics in the wake of the first oil shock. The concept was subject to numerous tests, both in cross-country and country-base studies. Its validity was supported by the findings of Sachs and Warner (1995) based on cross-section growth regressions covering 97 countries. The resource curse effect was found to be substantial. Economies with a high ratio of natural resource exports in 1971 were growing slower in subsequent years, on average by 1 per cent per annum. This finding is supported by Auty (2001) who concluded that between 1960 and 1990 per capita incomes of resource-poor countries grew between two to three times faster than those of resource-rich countries. Within the sample of resource-abundant countries, mineral exporters tended to manifest the weakest performance. Generally, empirical research on mineral exporters corroborates the view that they were most badly affected by resource curse.

Criticism was levelled, however, against the conceptualisation of natural wealth and the time period covered by the study. The latter is crucial, indeed, in the face of marked prices hikes and troughs featuring the international oil market. Recent cross-country studies contradict the findings of Sachs, Warner and Auty and deny a significant negative association between natural wealth and development (e.g. Chi-Yung 2004). Unfortunately, most cross-country regression analyses confound the different
types of natural wealth, such as dispersed resources like agricultural land and point-source resources like minerals and hydrocarbon sites. Country-based studies on the latter provide convincing evidence of the presence of DD effects. Case studies on oil-exporting countries support the view that negative developments coincided with the inflow of revenues (literature is legion; for Angola see Kyle 2002, for Nigeria Collier 1988). Even those who raise doubts about the alleged systematic link between natural wealth and economic malperformance, mostly acknowledge the existence of curse effects. Dissent, however, exists on the causal links that explain how natural wealth transforms into below average economic performance (see below).

Considering the empirics on DD, it is reasonable to assume that the macroeconomic impact via price changes and resource shifts is effective, though not inevitably the prevalent effect. Particularly oil-producing countries are most eligible to contracting DD, since oil windfalls are accruing at a relatively large scale, often quite suddenly, and concentrated in the hands of governments and a few individuals. In contrast to more dispersed natural capital like agricultural land and forestry reserves, the spending effect is likely to be more pronounced. Mineral and hydrocarbon resources hence constitute a bigger challenge to both macroeconomic adjustment and public spending.

The gist of the still ongoing debate can aptly be summarise by stating that “there are symptoms of the Dutch Disease in most instances of a commodity boom but that it is very difficult to disentangle DD effects from the domestic and international macroeconomic conditions prevailing at the time of the shock” (Stijns 2003, p. 3). The least that can be derived from the vastly deviating and contradicting conclusions of the DD empirics is a strong pointer to the potential harm DD can inflict particularly on countries of weak policy-making capacities. Under neo-classical conditions there would be no reason for concern. For whether a boom sector expands at the cost of other sectors would not matter to the overall level of welfare. Given a non-perfect environment, however, and especially if the growth of manufacturing is at stake, dynamic aspects come to the fore. If productivity growth, learning by doing prospects, breeding entrepreneurs, and creating economies of scale are attributed more to manufacturing than to primary resources sectors, there is a cause for insulating the rest of the economy from the booming export sector’s spill-over.

Despite the discrepancies with respect to the empirical findings on DD, there is widespread consensus on the pivotal role of government and public institutions. Three major strands of discussion can be distinguished referring to (i) how government should respond to the onslaught of DD, (ii) how institutions, economic attitudes and social capital are affected in the context of a “rentier state” based on oil windfalls, and (iii) the politics behind economic decision-making which is currently regarded the most important factor of success or failure of an oil-dependent country.

II Economic Policy under the Impact of Resource Booms: the Staple Trap

Whereas the macroeconomic model identifies DD effects in the absence of any policy interventions, the real world of oil-exporting countries is characterised by enhanced participation of governments in the economy and its increasing role in shaping the course of development. Unfortunately, this has in many cases been rather a burden than a boon. The many ramifications of government’s policy impact are aptly stylised by the staple trap theory. The staple trap argument focuses on the behaviour and incentive structure of a resource abundant economy. The concentration of windfall revenues in the hands of government and a small number of people or enterprises, which is characteristic particularly of countries with point-source resources, constitutes a strong temptation to increase private and public consumption. This is manifested by a rapid expansion of the civil service and a huge increase of public good supplies in the wake of oil booms. The problem with such spending sprees is the irreversibility – at least in the short to middle term – of these expenditures and the difficulty to scale down in response to declining
revenues. Thus in the face of boom-bust cycles that are typical of mineral and oil markets, resource-rich countries are prone to run into the pitfall of increasing debts.

Accumulation of debts is also owing to capital investments with low returns. Many countries have experienced unproductive investment booms. Particularly in the 1970ies, efficiency of investments virtually collapsed (Lal and Myint 1996). Industrial policies aimed at promotion of import-substituting and export manufacturing by means of trade protection and subsidies, created a further drain on public resources. Economic rents of natural resources were thus directed towards unproductive, non-sustainable ends. Even worse, they allowed governments to prolong wrong policies to the benefit of interested groups associated with economic activities which are nurtured by protectionist policies. Hence resource-abundant countries are eligible for postponing economic reforms.

Natural non-renewable resources are often not consistently and prudently deployed for the establishment of competitive non-boom sectors. Oil-dependency therefore tends to be reinforced by a lack of incentives to launch export-oriented industries. It is a characteristic feature of resource-rich countries to stick to closed trade policy (Sachs and Warner 1995; Sarraf and Jiwanji 2001). Periods of lower windfalls are usually bridged by additional international borrowing whereby future resource revenues are used as collateral. Resource abundance then indeed turns into a resource curse, albeit a policy-made one that is not simply brought about by macroeconomic forces as depicted in the DD theory.

III Institutions, Social Capital, and Incentives

Apart from DD and staple trap, the resource curse discussion has increasingly raised the impact resource abundance can exert on institution-building and the functions of the state. A comparatively recent strand of research identifies the negative effect of resources on the quality of institutions as the major channel of transmission to slow economic growth. Resource-abundant economies tend to be more susceptible to rent-seeking behaviour, due to the concentration of wealth and the common-pool phenomenon. This applies primarily to point-source resources such as oil and minerals. Economic attitudes, entrepreneurial aspirations and policy decisions are likely to be impaired by struggle for resource rents. Long-term development objectives such as a diversified economy, sound institutions, a proper tax system, functioning physical infrastructure and a high level of human capital are relegated to second order priority. The combination of resource wealth, lax legal structures, ill-defined property rights and imperfect markets may spawn destructive consequences, in extreme cases even civil wars which divert productive factors and destroy institutions.

The relationship between resource wealth and institutions is one of mutual influence: while existing institutions mould a resource boom’s impact on the economy and society, i.e. whether a boom turns out as blessing or curse, windfall revenues that fall on weak institutions tend to further undermine their quality. If a resource boom coincides with the state building process, it may give rise to a reinforcing tradition of power concentration, uneven development, cronyism, factionalism and rent-seeking.

The significance of institutional quality was subject to empirical tests on a cross-country base. Using different natural resource variables and controlling for potentially interfering factors, Sala-i-Martin and Subramanian (2003) arrived at the robust conclusion that natural resources, in particular fuels and minerals, have a negative impact on institutions. They also conclude that the inverse relationship between resource abundance and growth performance is exclusively caused by the deterioration of institutions in the wake of resource windfalls. In the context of their regression analysis, once this transmission channel is controlled for there is almost no effect on growth at all emanating from natural
resources. Hence institutions seem to have overriding significance in turning the resource impact in a curse or blessing.

Corruption is a well researched issue, for it is - second to civil war – the most obvious corrosion of social capital and misallocation of resources. According to a regression analysis covering 60 countries, its incidence is positively correlated with resource wealth and negatively with economic growth (Gylfason). Resource rents tend to undermine incentives to create wealth through productive activities and functioning institutions the relevance of which may wane due to the ability to gain access to wealth with less efforts.

Such a sentiment may also reduce private and public incentives to accumulate human capital. In the face of low taxes, generous social spending and the amenities provided by a government that responds to public pressures towards disseminating resource rents at a large scale, individuals and nations may tend to underestimate the value of education for long-term development prospects. School enrolment as well as public spending on education in percentage of national income, and expected years of schooling are inversely related to resource wealth (Gylfason, p. 7). Countries in possession of point-source resources again face a particular challenge. Though they may be in command of the means to foster education, there is a tendency to regard education as a consumption good and a largesse on the people, rather than an investment in human capital. Quality of teaching and labour-market orientation may not be assigned high priority. At the same time, the staple trap-induced predilection for a capital-intensive, inward-looking strategy facilitated by imported capital goods (as a symptom of DD) stunts labour demand and hence reduces the rate of return to education. While a few highly skilled workers earn a hefty wage premium in the booming sectors, the ordinary primary and secondary school leavers reap scant benefits.

This is another channel of transmission of resource abundance into slow growth. It has attracted more attention recently, and is likely to shift into the focus of concerns that non-renewable resources could provide only a temporary bulge of wealth if they are not utilised for effective capacity building across all sectors of the economy. This issue is likely to evolve into a key topic in the face of the unfolding global knowledge society. Competitive strength, foreign exchange earning capacity, employment and capital returns will increasingly depend on the quality of the national stock of human capital. Resource-rich countries have the means to invest relatively more, and some are doing quite well, as e.g. Botswana where public expenditure on education as a share of national income is among the highest in the world. Unfortunately, they have less incentives than resource-poor countries to vigorously pursue a labour- and education-centred development strategy (Birdsall et a. 2000).

B Turning Curse to Blessing: Fiscal Policies and Good Governance

Since the actual fallout of DD effects is considered to be shaped by government’s response to the revenue boost, policies and the forces behind policy-making have become the most prominent issue of the resource curse debate: what can policy makers do to avoid or mitigate a curse, what governs their actual behaviour, and what can make them do they ought to do?

There are different strands of analysis and policy devices, reflecting the relative importance attributed to the various aspects of resource curse. One extreme proposal is pleading for “leaving it in the ground” (Oxfam/Ross 2001) which is however not a realistic option. It would be unwise to forego the benefits of resource wealth, though the spread of exploitation and hence the time profile of the revenue flow is a serious issue. Whereas from a purely commercial viewpoint fast exploitation seems preferable, for the
overall economy a steady slow trickle of resource income may be easier to digest than a sudden surge. It would allow more time to adjust and to develop domestic industries geared to the booming sector’s demand.

There is general consensus that the major responsibility rests upon fiscal policies of resource-abundant countries. In the face of large windfall revenues fiscal prudence requires to prevent the inflow translating fully into greater aggregate demand, thus fuelling inflation and exchange rate appreciation. Government will have to resist spending pressures and set aside the surplus. Fiscal rules have been put in place in some countries aimed at smoothing the course of expenditures and saving revenues. Additionally, in order to avoid exchange rate appreciation appropriate demand management is called for, because in a high inflation environment currency devaluation cannot sufficiently control real exchange rate movements. This again points to the significance of revenue management and highlights the role of government as gatekeeper mandated to sterilize a part of the windfall income. Fiscal rules, revenue funds, transparency and proper governance structures are regarded as basic requirements of avoiding the pitfalls of resource abundance.

I Role and Design of Fiscal Rules

In pursuance of prudent and sustainable fiscal policies oil-exporting countries are confronted with unique challenges. They arise from the fact that oil resources are exhaustible, while prices and revenues are volatile and uncertain. Proper fiscal management therefore has to take care of
i) sustainability and intergenerational equity with regards to the usage of natural wealth, and of
ii) stabilisation of public expenditures in order to insulate the economy from oil market swings.

Evidently both objectives will not be met by just allowing expenditures to follow the pace of oil revenues, as can be observed, indeed, in many countries. It is still not sufficient to take the overall budget balance as yardstick of the fiscal stance (as e.g. in the Maastricht Criteria of the EU). The design of fiscal rules for countries of high dependence on exhaustible resources and volatile revenues which represent transfers from abroad, is more complicated.

The long-run consideration taking sustainability and preservation of wealth into account regards oil wealth as an asset which provides a stream of revenues over a specified period of time. Fiscal proceeds are considered a transformation of oil into financial assets. Hence they are simply a portfolio transaction and cannot be taken for income to be spent on consumption or otherwise. The challenge faced by fiscal policy is to decide how to allocate the total (i.e. oil and non-oil) public wealth across generations. The permanent income argument would require that current consumption be limited to a level that matches the return on the total stock of wealth, preserving the latter fully to the benefit of future generations. While a certain share of revenues will be used to cover current budget gaps (the non-oil balance), revenues have also to be transferred to the stock of financial assets. These have to be built up at a rate that allows for full compensation by interests and dividends of oil revenues once the resources are depleted. The level of income derived originally from natural wealth will thus be maintained while the structure of its source, government’s assets, gradually changes in the course of time.

Specific indicators of fiscal stance in oil-exporting countries are designed to operationalise this framework (Barnett and Ossowsski 2002; Baunsgaard 2003). Most important in this respect is the non-oil balance which provides a clearer picture of the fiscal stance than the overall balance. In contrast to the latter, it is under the control of government and a better measurement of fiscal policy performance. The overall balance is subject to oil revenue swings. It can improve due to rising prices, while the non-
oil balance deteriorates, and vice versa. To assess financial needs and fiscal vulnerability, the overall balance is an important indicator. Yet the design of a fiscal rule must refer to the non-oil balance excluding interest payments and receipts (primary non-oil balance).

The basic challenge is to set a level of constant non-oil deficits that can be sustained throughout the lifetime of oil extraction and beyond, supported increasingly - and in the end completely - by revenues from non-oil assets built up by savings from oil revenues. Assuming no uncertainty on the relevant parameters (stream of revenues, interest rates) the savings out of current revenues required to offset the gradual decline of oil resources and the share allocated to cover the non-oil deficit can easily be figured out. This calculation provides a fiscal rule for the size of the non-oil primary deficit which leaves scope for the accumulation of non-oil assets sufficient to ensure that the total wealth and the income derived are kept on a constant level (which has been estimated at between 15 and 25% of non-oil GDP for Nigeria; Baunsgaard 2003, 19). In the real world, uncertainties exist on future prices, extraction costs and size of deposits. They do not negate the validity of the concept of non-oil balance, but rather give reason for precautionary savings.

A fundamental question concerns the treatment of capital investments. Public investments in physical assets would be justified only if the return (future tax revenue) matches the return on financial assets. Since low profitability of government investments is one of the features of the staple trap, a drastic shift of the investment focus towards financial assets will follow from the introduction of a fiscal rule. An enforcement of the non-oil balance rule which excludes or minimises capital investments, would assign the financial assets the task of ensuring sustainability, and relegate the state to the role of a mere observer. This stance is based on the (Washington Consensus inspired) opinion that resource booms have resulted in undue expansion of the government sector and crowded out private economic activities. Taking resources off the hands of government, therefore, is seen as a means to redress the imbalance of public and private sectors. Under existing gaps in the social and physical infrastructure, however, it may be difficult to find political support for redirecting investments to financial assets (which are preferably held abroad, to booth). While it will be rare to find public investments the profitability of which beats financial investments, to entirely exclude capital investments from the assets portfolio would be close to negating a positive role of public investments for economic and social improvements. However, exempting physical capital expenditures from the rule’s binds would invite creative accounting. Hence a general consensus on the relationship between government and society and the functions of the public sector is required.

In the short run, stabilisation of government spending is aimed at minimising procyclical effects on the domestic economy of fluctuating international oil prices. Macroeconomic costs of fiscal volatility caused by a close correlation between public expenditures and oil revenues, are extremely high. Procyclicality is regarded a key policy factor in the disappointing economic performance of many oil-producing countries as it subjects the economy to adjustment strains that may stunt inherent growth potentials (Barnett and Ossowski 2002). Fiscal costs, too, are significant as boom-bust cycles tend to compromise the efficiency of public spending.

From a short-term perspective, the share of the non-oil balance in the non-oil GDP is a proxy of government’s demand on the national economy. A rising non-oil balance will indicate an increase in public expenditure at constant levels of domestic revenue collection, whereas the overall balance may conceal procyclical spending. In order to control pressures on domestic demand and concomitant spillover effects towards real appreciation, inflation, interests and the external budget, it is paramount to monitor the non-oil fiscal stance.
Evidently the non-oil balance would provide the best design of a fiscal rule. But price-based rules could be an appropriate proxy and easier to apply in the short-term. They target a balanced budget at a reference oil price and require the surplus of actual revenues over the notional revenues to be transferred to the stock of financial assets. While the non-oil primary deficit rule which targets a constant deficit, provides a more effective insulation against the different factors of volatility, the price-based rule is likely to be effective in stabilising the non-oil balance fairly well and, moreover, has advantages in terms of simplicity. For monitoring and evaluation purposes, however, the non-oil primary deficit is still regarded the most important measurement, and governments which do not yet include this indicator in budget documents, should be encouraged to do so.

Success or failure in establishing fiscal rules will, however, not primarily hinge on the formula chosen. There are problems in establishing and sustaining political support for any rule-based fiscal policy. Most noticeable are the challenges in the initial phase, particularly in a situation of expansionist fiscal policies which necessitates a well balanced switch, the need to operate asymmetrically until savings are built up which can be drawn on in low price periods, and the involvement of subnational units in order to ensure that they do not violate the rule.

II Oil Funds: Problems or Solutions

Extra-budgetary funds have become fashionable among oil and mineral producers in the wake of high and volatile prices. They are basically designed to serve two purposes: stabilisation funds are a means to insulate the government budget from sharp fluctuations of oil revenues and to smoothen the trajectory of public expenditures. While they receive budget surpluses in periods of high prices and revenues, they will finance shortfalls in lean years. Thus they help avoid severe budget cuts and align actual spending to budget projections. Saving funds set aside a part of the oil revenues to build up financial assets in the long run. They are aimed at flattening the intertemporal allocation of resources in consideration of the exhaustibility of oil deposits. It is evident that funds and fiscal rules serve similar purposes. In reality, funds to exist without clear-cut fiscal rules and vice versa.

The rationale of stabilisation funds seems convincing, yet the fund management poses considerable problems. The international oil price does not fluctuate around a constant average. Fund policies have to adapt to this feature or run the risk of collapsing like the commodity price stabilisation schemes in the 1980ies and 1990ies. By linking the reference price (above which the funds receive revenues from the budget and below which they transfer to the budget) to an actual moving average price, they may smoothen, rather than stabilise, public finances. But even this less ambitious objective will not be met unless government spending is effectively controlled by the imposition of a liquidity constraint. In the absence of such constraint, government could borrow or sell assets and still indulge in higher spending, while transferring revenues to the fund. There is even a temptation to borrow in times of high oil prices, as the access to credits is easier due to the increased value of oil reserves. A stabilisation fund hence can not at all substitute for prudent fiscal policy.

Saving funds are faced with a similar problem. They are effective only if the saving rate of government is stepped up. Again there is the temptation to take to increased borrowing concurrently with transferring revenues to the saving fund. Firm policy decisions are called for in order to bring to fruition the potential advantages of any oil fund. A fund would make saving easier provided it is embedded in a conducive fiscal policy framework. These are the main prerequisites of a well-functioning fund:
• It must be integrated and coordinated with the budget to ensure overall fiscal control and strengthen expenditure policies. Funds should not adopt specific development objectives nor undertake government spending.

• Assets should be placed abroad in order to attenuate DD effects on the real exchange rate.

• Though a huge fund may give rise to growing spending pressures, transparency on the funds operations is paramount in ensuring good governance. Hiding information on the funds volume and operations may sow distrust. Funds are susceptible to abuse and political interference. Definitely the strongest safeguard of the fund’s integrity is transparency.

Empirical evidence suggests that funds had hardly any measurable influence on governments’ expenditures. Among the countries that have established funds, those with a weak fiscal reputation did not succeed in delinking expenditures form oil revenues (Davies et al. 2001). There are, though, also success stories, the most renowned one being the State Petroleum Fund of Norway. But the saving funds of Botswana, Kuwait and Alaska as well as the stabilisation fund in Chile have been successful, too (Fasano 2000). Nowhere, however, have funds been able to substitute for sound fiscal management and discipline.

III Transparency and Accountability

Nontransparent practices in dealing with a nation’s natural wealth contain enormous risks and incur substantial costs in terms of development foregone. Measures towards institutional strengthening aimed at improving transparency could hence yield high returns. Given the high costs of inefficient policies, discretionary administrative behaviour, and outright corruption and considering the fact that oil wealth tends to nurture these symptoms, there is a compelling reason to end the opaqueness of resource revenue flows. Beneficiaries of information disclosure are the citizens, but also government and companies. Transparency on oil contracts and revenues allows to assess the business and financial situation on firmer grounds and to lower interest rates and risk margins. It provides national and subnational public institutions with more and more reliable information on revenue availability and helps to coordinate budget planning and implementation. Citizens get access to information needed to evaluate government’s fiscal policy performance and to participate in open budget processes. If indeed the impact of resource abundance is conditioned by the quality of institutions as argued above, then the key approach to turn curse to blessing is the improvement of transparency and accountability structures.

This was recognized and put forward around the turn of the millennium by international organisations, in particular the IFIs, but also CSOs and governments. New discoveries and the emergence of new oil and gas exporting countries raised concerns that the bad experiences of the past be repeated and new chances be missed out again. Numerous initiatives were launched on the global arena, with the most important ones being driven by the IMF, World Bank Group (WBG), and G8. The UK launched the Extraction Industries Transparency Initiative (EITI) with the support of many other countries and organisations, including CSOs.

The IMF is the most advanced advocate of fiscal transparency in general and of resource-abundant countries in particular. Based on its Code of Good Practices on Fiscal Transparency (updated in 2001) the IMF produced a Manual on Fiscal Transparency and, as a special application of the Manual, the Guide on Resource Revenue Transparency, a draft of which was published in December 2004. It presents the most comprehensive investigation tool covering all aspects pertinent to the sources and
wherewithal of resource revenues. The Guide resembles the structure of the Code and the manual which address a host of items under four main topics:

1) **CLARITY OF ROLES AND RESPONSIBILITIES**

   Legal framework of resource ownership and licensing, tax laws, oil contracts and agreements, loans and liabilities, government equity participation, extra-budgetary funds, ownership and responsibilities of national companies, subnational governments

2) **PUBLIC AVAILABILITY OF INFORMATION**

   Comprehensive and complete budget documentation, including payments by companies, resource-related debts (collateralisation of revenues), resource-related financial assets, estimation of resource asset worth, and quasi-fiscal activities of companies as well as compensation thereof.

3) **OPEN BUDGET PREPARATION, EXECUTION, AND REPORTING**

   Rate of exploitation and long-term fiscal sustainability, fiscal rules applied to funds, investment policies for assets, fiscal balance (overall and non-oil), internal control and audit procedures.

4) **ASSURANCES OF INTEGRITY**

   Companies’ compliance with international standards of accounting and reporting, reports of national audit office or independent third party to parliament on revenue flows to government.

Besides the Manual and the Guide, the IMF has produced “Reports on the Observance of Standards and Codes” (ROSCO) for a number of countries, including oil-exporters. The Article IV consultations also cover issues relating to fiscal transparency and resource revenue management. The IMF has repeatedly encouraged and supported governments to enhance revenue and contract transparency, as for example in Kazakhstan and Nigeria (Bank Information Center 2004).

The **WBG** is actively promoting transparency through various programmes and projects. It supports the Chad-Cameroon Pipeline with its unique institutional set-up, assists in building capacities to implement revenue transparency, e.g. for CSOs in Azerbaijan, supports the EITI (see below), and collaborates with the IMF in refining the guidelines for reporting. A review of the WBG’s involvement in extractive industries sectors, which was presented in December 2003 (Extractive Industries Review), recommended to stipulate revenue and contract transparency for extractive industries projects. This proposition was adopted by the management of the WBG, albeit not as a stringent conditionality. The WBG prefers to raise the transparency issue in a voluntary approach and exempts what is considered non-significant projects.

**EITI** was launched by U.K. Prime Minister Tony Blair at the World Summit in Johannesburg on September 2, 2002. It aims to increase transparency on resource revenues by standardised reporting requirements specified for governments and companies. EITI convenes governments, companies and CSOs and is logistically supported by DFID. The initiative has received broad support from a wide range of multinational and national companies, NGOs and multilateral institutions. African countries are represented by the governments of Angola, Botswana, Cameroon, DRC, Equatorial Guinea, Ghana, Nigeria, Sierra Leone and South Africa, and by the NGOs African Network for Environmental and Economic Justice and Angolan Civil Society.

The main thrust of EITI is to provide standard procedures and templates for reporting to make sure that revenues are fully accountable. Specific standards are designed for host governments and for companies. Both sets of data are to be aggregated and analysed by an independent auditor. The
coverage of reporting under EITI is, however, limited as it includes only upstream activities (i.e. up to the final point of marketable production). Yet it is a milestone in the development of revenue reporting and has already encouraged the governments of Ghana, Nigeria ("Fiscal Responsibility Bill"), and the DRC to address deficiencies in public accounting systems.

EITI shares a weakness with the IMF and WBG initiatives which is inherent in the voluntary approach and the fuzzy link to specific commitments in lending operations. International companies may be penalised for disclosing information on payments without approval of the host government. This collective action problem can only be overcome by binding rules on reporting. Mandatory disclosure could be enforced by a variety of regulations, such as listing rules, company laws at the national or EU level, amendment of International Accounting Standards and the relevant UN convention. Short of binding rules EITI is likely to have limited effect only.

IV Civil Society, Transparency, and Good Governance

While the IFIs focus on governments and financial markets, the potential role of civil society in promoting fiscal transparency has for long received only little attention. However, numerous initiatives of CSOs have been launched recently. They are increasingly acknowledged as they “seem to offer considerable longer term potential for bringing about a sustainable strengthening of domestic institutions for more accountable and effective fiscal management” (Petrie 2003, 16).

The most prominent NGO-led initiative is the Publish What You Pay campaign (PWYP). It lobbies for legal action to enforce upon publicly traded resource extraction companies disclosure of payments, taxes, royalties, fees and any other transactions with host governments and public sector units. PWYP was launched by Global Witness and the Open Society Institute, and is supported by more than 100 NGOs all over the world. The campaign addresses a major problem the aforementioned initiatives haven not yet taken on. In the absence of binding regulation host governments may shun companies willing to disclose the information requested. A general rule covering equally all companies would solve this problem. However, as the regulation is applicable only to publicly listed companies, payments of private and state-owned companies would not be covered. A substantial amount of revenue would not be reported (Human Rights Watch, vol. 16, 86 f.).

A number of international and national NGOs are specialised on budget work. The International Budget Project (IBP) assists CSOs and researchers to analyse budget policies and to improve procedures and institutions in developing countries. IBP has formed a network covering about 25 countries. The constituency originates to a great extent from NGOs dealing with the social impact of expenditure policies of the resp. governments addressing issues such as health and education. The focus of IBP is, however, put on fiscal transparency because it was realised that lack of information is the main barrier for NGOs to engage government in public debate on spending policies.

The Institute for Democracy in South Africa (Idesa) conducted a study on fiscal transparency in South Africa with the support of IBP. The study drew on the IMF Code, but additionally considered public participation in the budget process as an element of fiscal transparency. The Africa Budget Project, launched by Idesa, has lent itself to comparative studies of fiscal and budget transparency in African countries.

The Open Society Institute’s Revenue Watch seeks to enhance the capacity of local groups to monitor revenue management and ensure that revenues be invested for public benefit (OSI 2005). There exist many more organisations operating on different levels, though well connected in global and regional networks which render access to professional expertise and information necessary to deal with the highly technical issues of fiscal policy.
With the number of CSOs active in budget work expanding, their analytical and political clout is being increasingly recognised. They collect and analyse data IFIs cannot access. Although they tend to put a narrow focus on expenditures, they do provide key inputs into assessing fiscal transparency in areas such as tax administration, procurement, regulation, and availability of fiscal information to the general public (Petrie 2003, 21).

C Conclusions

The existence of resource curse effects cannot be denied, since the impact of price and exchange rate movements and sectoral shifts has been identified unmistakingly in numerous resource-abundant countries. Findings of cross-country regression analyses do not unanimously support this conclusion. But it has to be taken into account that on a cross-country level DD effects will easily be blurred by country-specific conditions and responses. Thus diachronic case studies are more informative on the actual and potential impact of resource booms. The debate on causes and symptoms has highlighted the significance of economic policies in general (the staple trap argument) and of fiscal management in particular. There is wide consensus that the incidence and severity of curse effects are first and foremost to be blamed on government policies and public institutions. Despite different views concerning the transmission route connecting resource abundance to economic underperformance, empirical research mostly points to institutions and policies through which the resource impact is being channelled, and less via markets. These conclusions attach major responsibilities to governments and put policies and politics in the centre of analysis (not least influenced by new political economics). Inappropriate fiscal policies and weak institutions have allowed resource curse effects to unfold and thwart growth and development.

In order to redress these deficiencies, the introduction of fiscal rules has been suggested, mainly by the IMF, aimed to clog one important channel of DD, the lush spending of resource revenues. Rule-based fiscal policy has the potential to reduce the volatility of spending and increase public spending, provided it is supported by prudence and foresight in general policy decision-making. The design of fiscal rules needs to reflect fundamental policy decisions concerning the development strategy and the role of government. Fiscal rules as proposed by IMF imply an extremely conservative fiscal approach that will certainly not go well down with governments and constituencies in many countries. The rules seem to reflect the Washington Consensus which is bent on curtailing the role of state. It is no surprise, that fiscal rules of such stringency have not been introduced yet. Even the Government of Norway, though reporting on non-oil balances, does not apply this parameter to the management of the country’s oil revenues.

Saving and stabilisation funds are not a necessary ingredient to prudent fiscal management, as governments could also set aside revenues in central bank accounts or foreign deposits. Nor are they a sufficient condition as they could easily be abused for increasing opaqueness with regard to revenue flows and to shun parliamentary or public control. Fiscal rules and oil funds are condemned to ineffectiveness, if they are not embedded in a conducive environment characterised by prudent policy-making and good governance.

Transparency is a fundamental requirement of good governance as it provides all stakeholders the opportunity to meaningfully participate in decision-making. Policy restraints will become effective and help reduce waste and abuse of public revenues. Multilateral institutions have strongly advanced the cause of fiscal transparency. But they have obviously refrained from linking transparency commitments to lending operations, and thus thwarted the leverage they could exert on oil-exporting clients. Yet the reports on budgetary performance, particularly by the IMF, carry considerable weight, as they are considered by financial markets and bilateral institutions.
Still more important in the long run is the evolution of a domestic constituency in command of analytical and lobby capacities to engage governments in a public debate and to participate in open budget processes. Given such a context, fiscal rules and oil funds may assist in the evaluation of sustainability of government policies. Numerous endeavours towards enhancing the capacities of CSOs for budget work have already been made. CSOs have contributed substantially to PRSP (e.g. the Uganda Debt Network), to CAS consultations and those required under the Cotonou Agreement. Getting ahead with budget work in resource-abundant countries, however, is all the more important as a unique, not recurrent opportunity to steer the course of development by harnessing non-renewable resources is at stake.