

CORRUPTION IN NATURAL RESOURCES

Natural resources often provide fertile ground for corruption. Since a substantial number of partner countries in development cooperation are richly endowed with natural resources, these contexts pose a particular challenge for effective donor action. The risk of corruption cuts across several natural resource sectors, from non-renewable resources such as oil, gas, minerals and metals, to renewable resources such as forests, fisheries and land. There are, however, important variations in the challenges presented by these sectors and the manner in which corruption in relation to them can be addressed.



The basic relationship between corruption and natural resources is twofold. Firstly, the presence of natural resources may cause corruption. The existence of appropriable resource rents, for which various social groups may vie, can result in a high level of rent-seeking behaviour. Secondly, corruption may occur within natural resource management (NRM) systems themselves, leading to the suboptimal use of these resources and to poor development outcomes in terms of economic growth and/or poverty reduction. The level of corruption within NRM systems is a product not only of the resource endowments at stake, but also of the institutional arrangements in place to govern their use. Donor interventions to reduce corruption in NRM therefore need to address both the potentially negative impacts of resource rents (including rent-seeking and patronage) and the design of governance systems for their proper management. The latter may involve, for

example, promoting good concession or negotiation practices, promoting transparent and accountable revenue and expenditure management, or helping to curtail petty corruption in monitoring and enforcement systems. In this article, we provide a broad overview of the relationship between corruption and natural resource management, outlining the main challenges and issues at stake. We also point to possible areas for donor intervention, though without making specific policy recommendations.

How natural resources corrupt

There is a growing body of evidence that natural resources can be a curse rather than a blessing. Countries endowed with natural resources, on average, grow more slowly than countries without such resources. What is commonly referred to as the 'resource curse' has been linked by research both to rent-seeking behaviour and to patronage. Yet the largely positive experiences of certain resource rich countries, such as Botswana and Norway, suggest that the resource curse need not be deterministic, and that there are ways of influencing the impact of resources on institutions and on development.

Recent analysis emphasises the effects of resource rents on corruption. One argument is that natural resource rents lead to rent-seeking, or the socially costly pursuit of rents. Though rent-seeking and corruption are not one and the same, some forms of rent-seeking do qualify as corruption.

The main problem is not that there is competition for rents, but that the skills, time and energy individuals use to compete for resources could have alternative uses. In oil rich countries, skilled individuals can benefit more from becoming oil bureaucrats than from starting a business in another field. This is socially costly as it entails the redistribution of an existing cake rather than the cake's expansion. Where resource rents are high and institutional quality is low, a number of entrepreneurs will choose to become rent-seekers.

If there are externalities in production (i.e. profitability increases in the number of producers), an increase in resource rents will cause so many entrepreneurs to shift into rentseeking that total national income will be reduced. Rentseeking can therefore be said to make the size of the cake smaller, or an economy worse off, even though it has received an additional infusion of income through natural resources.

A rent-seeking perspective suggests that countries with bad institutions suffer a resource curse, while those with good institutions do not. Some rent-seeking models, however, suggest that additional factors are also important in determining whether natural resources lead to increased rent-seeking: the effect of resources may depend on the initial level of rentseeking, while ethnic fractionalisation in a country may exacerbate rent-seeking problems.

Another argument focuses on patronage. Increased natural resource rents also provide governments with more opportunities and greater incentives to pay off political supporters to stay in power. Since being in power means having access to resource rents, politicians are willing to spend more today to stay in power tomorrow. A politician can, for example, choose between consuming resource rents or spending them to provide public sector employment for his or her supporters to increase the probability of being re-elected. Public funds used on patronage of this kind could have been spent in more socially productive ways, meaning that patronage implies an inefficient allocation of public resources.

In this context, rents from natural resources have two effects:

i) they increase income directly and indirectly, ii) but the incumbent has greater incentives to provide supporters with inefficient public sector jobs. If institutions are sufficiently bad, the latter effect may dominate the former, causing national income to fall. The critical institutions are those that govern the allocation of public resources, i.e. institutions that hold politicians to account for their use of public funds. There is an important relation to the rentier state here in so far as natural resource rents may weaken accountability of governments to citizens. By controlling substantial oil revenues, governments can reduce pressures for accountability and democratisation, including direct oppression or the prevention of the formation of social groups independent of the state.

How natural resource management is corrupted

In general, a number of preconditions are required for corruption to take place in resource management systems. First, there must be personal benefits for those involved in the corrupt act; second, they must have the authority to influence decisions; and, third, they must have the opportunity to act corruptly within the institutions in which they operate. What constitutes a personal benefit is relative to the personal means of individual decision-makers, and could represent only a small fraction of the overall amount involved, for

example, in an oil concession contract. The authority to influence decisions related to the contract, on the other hand, implies a certain position within a bureaucratic hierarchy, while the opportunity to engage in corruption reflects the overall quality of the surrounding institutions.

Actors in natural resource management

Corruption in natural resource management can occur at all phases of resource exploitation, though some stages are more at risk of corruption than others and may be affected by corruption in different ways. Understanding the various roles and influences of actors involved in resource management is important for addressing these risks. The actual relationship between government and regulator, for example, will tell us something about who is in a position to demand bribes. The way production or revenue collection actually functions also tells us something about the degree to which bribes are 'needed' to manipulate regulatory conditions or if poor sector performance continues just because regulatory competence and control is too weak. For the private sector, we know that companies of all categories can be involved in corruption, although the type and extent of corruption may depend on company characteristics, like country of origin, size, sub-contractors, financing opportunities and more. To understand the risk of corruption – or opportunistic manipulation of framework conditions more broadly – the whole range of influential players should be considered. Not only firms, but also banks, consultants, export credit agencies, insurance companies, donors and foreign governments should be considered. The strength of each actor's role will depend not only on its own agreements with the government of the resource rich country in question, but also on the nature of its agreements with other actors, or the nature of agreements between these other actors and the government. Though resource management systems are intended to prevent informal solutions, there are strong incentives for various actors to make secret arrangements to obtain a favourable cut of resource concessions.

Corruption risks prior to operation

The risk of corruption will be different at different stages of resource extraction. Prior to operation, players may exercise significant pressure on the government to influence the legal framework for operation, criteria for the award of concessions, and market design in general. There may be substantial risk of corruption in this process – particularly since foreign governments may go far in securing benefits for 'their' firms and access to natural resources. After operation has started, in the early phases of managing a resource, there can be considerable uncertainty about the choice of management solutions, ownership issues, expected revenues, distribution and other political or economic considerations. Expert advice may point in different directions and there may be disagreement between local and national decision makers over how best to manage the resource. Some form of license agreement will commonly exist between the government and private firms, but the legal details of these arrangements may vary considerably in terms of control or ownership of the resource, the exploitation period and the sharing of revenues between the parties involved. The more uncertainty about how decisions are supposed to be made, the easier to defend deviation from the rules, and the higher the risk of corruption.

Firms may thus attempt to influence political decisions concerning resource management in various ways at the preoperation stage, including through honest marketing efforts, as well as grey-zone practices and clear-cut corruption.

Corruption risks during operation

Decisions about how much of a resource to extract, the length of time for which it can be extracted and who is permitted to conduct the extraction, are not always respected. Concession holders may abuse the terms of their agreement with sector regulators, and resources may also be harvested by those not legally entitled to do so.

Institutions are therefore required to monitor the use of resources and enforce basic regulations and contracts.

There is substantial scope for bureaucratic corruption in natural resource management, particularly where regulations are complicated, un-transparent or contradictory. In some countries, low wages coupled with non-

meritocratic hiring, firing and promotion practices mean that there is little to lose from taking bribes. Weak monitoring and enforcement capacities (both within resource management bureaucracies but also in other public sector bodies, such as customs) can also increase the prevalence of corrupt practices. After production has taken place for some time, actors may want to renegotiate the terms of their contracts. While renegotiations can be entirely legitimate, there is also scope for opportunistic renegotiation, which reduces or eliminates the expected benefits of competitive bidding at earlier stages in the process. There is also scope for corruption in renegotiations, for instance, where a government body or an individual official threatens to cut a firm's share of resource revenues to obtain a bribe.

Addressing corruption related to natural resources

Addressing the 'curse' of natural resources requires that we know the precise mechanisms through which natural resource rents affect development. Rent-seeking and patronage can explain the negative effects of natural resources on many economies, and there are a number of examples where these phenomena occur in natural resource rich countries. There is also considerable empirical evidence that corruption, in the form of rent-seeking and patronage, is at the core of the resource curse-phenomenon. The evidence shows that rent-seeking and institutions governing the private sector, as well as patronage and institutions of democratic accountability, determine whether countries suffer a resource curse or not.

Donor policy in resource rich countries should focus in particular on reducing corruption in the form of rent-seeking and patronage. Helping to improve the economic environment for entrepreneurs, supporting institutional development (including for parliaments and judiciaries), and supporting democratic reform, can all have a positive impact in resource rich countries.

Donors must be careful, however, that their support does not intensify rent-seeking behaviour and patronage networks in resource rich contexts. This has implications not only for the type of aid support given, but also for the process through which aid interventions are decided. Direct budget support, for example, may work to directly increase the pool of revenues to be fought over in countries where natural resources are abundant.

Making natural resource management systems themselves less corrupt is, of course, extremely important. Donors can play a role in promoting good concession and negotiation practices that prevent favouritism and ad hoc bureaucratic decisions.

However, concession laws and tender rules must not only meet international standards – their implementation and enforcement will depend on the interests of key domestic players, which must be analyzed in political economy terms.

Monitoring and enforcement capacity should also be addressed, and there can in some cases be substantial scope for improvement through new and simple technologies, which can be funded by donors. Resource revenue and expenditure management should be transparent, but to be effective, transparency must be coupled with accountability. This demands continuous and close analysis of the political and economic situation in partner countries that are rich in resources.

Conclusion

The resource curse is a continuing challenge for effective donor intervention in resource rich countries. It is particularly pronounced in contexts where the initial level of corruption is high, where existing institutions are poor, where there is an absence of political competition, a high degree of ethnic fractionalisation, and a low level of education.

A comprehensive approach is therefore needed to effectively transform resources into positive development outcomes. Corruption within natural resource management systems also needs to be directly addressed. Since corruption varies across industries and involves a variety of different actors, strategies to control the problem in individual sectors require concentrated review. Measures are often aimed at improving laws and standards, but their implementation and enforcement depends on the interests of key domestic players, which requires political economy analysis.

* Ivar Kolstad is a Senior Researcher at CMI and head of its Human Rights Programme; Tina Søreide is an Economist at the World Bank; Aled Williams is Programme Coordinator at U4.

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