FOREWORD

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"Resource curse" is the term used to describe the failure of resource-rich countries to benefit from their natural wealth. Perversely, many countries rich in natural resources are poorer and more miserable than countries that are less well endowed. This is clearly visible in Africa. The Congo, Angola, and Sudan have been torn by civil strife, and Nigeria suffers from endemic corruption, while resource-poor countries such as Burkina Faso and Ghana are equally poor but more peaceful and democratic.

Lifting the resource curse could change the fate of the countries concerned and make a significant contribution to achieving the United Nations' Millennium Development Goals. It should be easier to recapture existing but misappropriated mineral wealth than to create wealth where it does not exist. Thus the resource curse offers a fertile field for benevolent intervention, and much progress has already been made.

As this book explains, the resource curse is a complex phenomenon. Three different processes come into play. The first is the currency appreciation due to resource revenues and its negative effect on the competitive position of other industries. This is called the "Dutch Disease." The second is the fluctuation in commodity prices and its disruptive effects. And the third is the effect on political conditions. The first two 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. The explanation has to connect economic theory with political theory.

I should like to use this occasion to summarize my own views on the subject. For purposes of analysis, I distinguish between four sets of players: international oil companies, national oil companies, and the governments and the people of the countries concerned. I am using oil for the sake of simplicity. A similar analysis can be applied to other commodities, although it will differ in many particulars. I couch my analysis in terms of three kinds of asymmetry: asymmetric information, asymmetric agency, and asymmetric bargaining power. Of the three, asymmetric agency problems are by far the most important. I shall make it the focal point of my analysis, giving the other two asymmetries a supporting role.

Agency problems arise when the agent does not faithfully serve the interests of the principal. The first step in an analysis is therefore to identify the principal. This is where political theory comes in. The ownership of natural resources is an attribute of sovereignty. According to modern political theory, sovereignty belongs to the people. That was not always the case. Before the French Revolution, sovereignty belonged to the king, but in the French Revolution the people deposed the king and they assumed his sovereignty. In other parts of the world, such as Saudi Arabia, the symbolic transfer of power never occurred. Nevertheless, for the purposes of studying the agency problem, we identify the people as the principal.

Foreign oil and mining companies need to obtain concessions to exploit natural resources. They can obtain them only from the rulers of the countries, but the rulers are not the principals. They are 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 prone to civil strife.

This is the key agency problem and the primary source of the revenue curse. It is asymmetric in the sense that it affects only the principals on one side, namely the people of the countries concerned, not the other side, the owners of the oil and mining companies. The managers of these companies faithfully represent the companies' interests and that involves doing whatever they can to obtain concessions on the most favorable terms possible. This has, in the past, included bribing and exerting other pressures on the rulers.

The resource curse has a murky history. International mining and oil companies could often enlist the support of their governments. They used to routinely pay off the rulers and colluded with them in not disclosing payments. They also used to exert themselves in keeping the right people in power, or on occasion support armed insurrections in the expectation of obtaining concessions. More recently, U.S.-based companies have come under the constraints of the Foreign Corrupt Practices Act and other OECD-based companies under its anti-bribery codes. Publicly traded companies are also subject to pressure by public opinion, and some managements, exemplified by British Petroleum, have developed their own ethical standards. But history has not come to an end. Constraints imposed on international oil and mining companies do not apply to Russia, China, or India. And there are many international operators who are not similarly constrained. The no-holds-barred hunt for natural resources continues unabated.

Historically, international oil and mining companies benefited from asymmetric information and asymmetric bargaining power. That is how they managed to capture most of the natural resources in the less developed world. But conditions have changed. After World War II, rising nationalism and democratic aspirations made resource-rich countries more assertive. In 1951, Mohammed Mossadeq nationalized the Anglo-Iranian Oil Company. He was overthrown by a CIA-led coup, but some 20 years later a wave of nationalizations swept through the major oil-producing countries, leading to the first oil crisis. Since then, bargaining power has shifted in favor of the oil-producing countries. Nondemocratic governments could count on acceptance and support from the governments of oil-consuming countries. This has been an important element in the lack of democratic development in the Middle East. The current tightness in oil supplies has reinforced this unfavorable trend.

The creation of national oil companies has largely cured the asymmetry in information and the formation of OPEC has shifted the bargaining power in favor of oil-producing countries. Since then international oil companies have been largely confined to newly emerging oil-producing countries where they still enjoy informational and bargaining power advantages.

National oil companies give rise to a different set of agency problems, however. Depending on their stage of development, they can offer an effective antidote vis-à-vis the international oil companies with regard to all three asymmetries. They are liable, however, to aggravate the agency problem at the governmental level and run into agency problems of their own. National oil companies can serve as a power base for nondemocratic governments as well as a source of internal corruption. Resource revenues provide a nondemocratic government both with the financial means and the incentive to maintain itself in power. Elections can be rigged using the resources of national oil companies because the companies are not accountable to the public. When the rulers are in possession of revenues that do not pass through the national budget, or the budgets are not transparent, there is an agency problem and democracy is endangered. Russia is the best example but the problem arises whenever governments depend on rents from resource revenues rather than from taxes.

While the establishment of national oil and mining companies may have largely eliminated the asymmetry of information between international companies and the governments of the resource-rich countries, a different kind of asymmetric information persists. The citizens of resource-rich countries have very little information about the extractive industry-related activities in which their government engages. Unless the people understand better how much money is flowing and where, the asymmetry will persist. The obvious remedy is greater transparency and accountability. This is an area where a broad-based international transparency campaign is beginning to make inroads.

The resource curse is a major scourge, but it can be cured. It has now been recognized that transparency and accountability are the remedies. A powerful movement has emerged to advocate it. It started with the Publish What You Pay campaign launched in early 2003 by Global Witness and other nongovernmental organizations. This was taken up almost immediately by the British government and became the Extractive Industries Transparency Initiative. My foundations have sponsored revenue watch initiatives in several countries. The Revenue Watch Institute, which is being established with the help of the Hewlett Foundation and others, will seek to institutionalize these initiatives and to broaden public understanding of the resource curse phenomenon and its cures.

Escaping the Resource Curse is the first volume in the Initiative for Policy Dialogue (IPD) series at Columbia University Press, but it is also the third in the Revenue Watch publication series. The first, *Follow the Money,* provides practical information to civil society groups in resource-rich countries on how to become effective monitors of government earnings and expenditures. The second, *Covering Oil,* was also produced together with IPD and offers journalists practical information about the petroleum industry to give them the background information needed to write in-depth analytical and investigative reports on the effects of extractive industries in their countries. *Escaping the Resource Curse* fulfils an important role not addressed by these other publications. Directed toward policy makers and those interested in influencing policy, it provides practical and independent advice from leading experts to policy makers in resource-rich countries about how to maximize long-term benefits from their natural wealth and avoid the pitfalls of the resource curse.

I am happy to endorse the book and the movement to hold governments accountable by contributing this Foreword.