

**THE RESOURCE CURSE:
EXAMINING CORRUPTION IN THE EXTRACTIVE INDUSTRIES**
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PERSPECTIVES ON GLOBAL ISSUES
VOLUME 2, ISSUE 1, AUTUMN 2007
WWW.PGI-ISSUES.COM
NEW YORK UNIVERSITY

CORRUPTION AND ITS VARIOUS PARTICIPANTS

The impact of corruption in the developing world results in poorly managed public sector institutions, a weak rule of law, and citizens suffering economic and social hardships because their country's resources are being diverted from serving their needs to promoting the self-interest of corrupt officials. Corrupt practices in public sector institutions reduce a country's economic viability while victimizing the society as a whole by diminishing the state's ability to provide for its citizens.¹ Corruption, according to Huguette Labelle, the chair of Transparency International, "remains an enormous drain on resources [which are] sorely needed for education, health, and infrastructure."²

Many anti-corruption programs focus solely on political corruption performed by endogenous institutions in developing countries, without regard to the role that external actors play in perpetrating fraudulent activities. For instance, in the area of international business, transnational companies actively participate in corrupt practices in developing nations for their own personal gain. Their participation in fraudulent activities with governments in the developing world diminishes the capacity of these public sector institutions to provide the necessary services to their society. Such participation by foreign entities also undermines the political stability of developing nations whose dishonest practices exacerbate volatility in the political climate. In essence, the impact of corruption in developing countries transcends its

¹ Cheema, Shabbir and Dennis Rondinelli, eds. Reinventing Government in the Twenty-First Century: State Capacity in a Globalizing Society. Bloomfield, CT: Kumarian Press, 2003.

²"Persistent Corruption in Low-Income Countries Requires Global Action." Transparency International Press Release 2007 (9 September 2007): accessed at: <http://www.transparency.org/news_room/latest_news/press_releases/2007/2007_09_26_cpi_2007_en>

influence beyond national borders into the realm of the global community. Hence, corruption in the developing world is a global dilemma.

The focus of this paper is to examine global corruption in the context of the natural resource curse. This paper will address how global corruption frames the paradox of why many resource-rich countries are among the poorest in the world; and how policy changes can combat corruption in extractive industries by strengthening the judicial mechanisms in resource-rich developing nations, while instituting more stringent laws toward transnational companies in developed nations.

EXAMINING THE PARADOX: RESOURCE-RICH BUT ECONOMICALLY POOR

Resource-rich countries in the developing world are plagued with the paradox of possessing a large quantity of highly valued global commodities, such as oil and gas, while still achieving abysmally low levels of economic growth. Natural resources, such as oil, timber, gas, and minerals, can be an important source of revenue for developing countries and could serve as a basis for poverty reduction, economic growth and furthering development. However, high levels of corruption due to the lack of transparency in transactions between domestic governments and transnational enterprises curb the potential of these revenues to lift resource-rich developing nations out of poverty.

The resource curse is a term defined by economists as the inverse relationship between the low or absence of economic growth in a country filled with highly valuable resources³. The paradox of the resource curse is that valuable natural resources create economic stagnation in a

³ Karl, Terry Lynn. "The Oil Trap." Transparency International Quarterly Newsletter (September 2003): 9.

developing country rather than economic growth. Some of the poorest countries in the world have the largest reserves of natural resources, and yet cannot seem to lift their state out of poverty despite this wealth in their ‘backyard.’

Economists note that the causes of the resource curse are a combination of four factors:

1) The especially high price volatility of [oil, gas, and mineral resources], which harms planning, budgetary discipline and [economic] growth; 2) the long-term price deflation of [natural resources] compared to the cost of imported manufactured goods, which tends to promote adverse balance of payments; 3) the poor employment generation and technological diffusion of the [natural resource] sector; and 4) the ‘Dutch Disease,’ an economic disorder linked to booms that causes exchange rates to rise, but eventually results in higher costs and reduced competitiveness of non-booming sectors, [such as agriculture...effectively calling] on a greater dependence on the natural resource.⁴

While the resource curse phenomenon explains the fiscal shortfalls that result in poor export strategies of developing countries, it does not explain the loss of billions⁵ of dollars in potential revenue.

If most resource extraction takes place in the developing world, then one would reasonably expect that the local communities where these resources lie would benefit economically. According to the Royal Institute of International Affairs, “projects in the extractive industry [have the potential] to generate sizeable revenues, create jobs, business opportunities, and often bring new roads and access to water and power to isolated rural areas in which they are

⁴ Ibid.

⁵ All dollar amounts throughout the paper are expressed in US dollars.

typically located... [Consequently stimulating] economic growth, [reducing] poverty, and [raising] living standards in host countries.”⁶ While this is the case for Australia, Canada, Norway, and the United States, this is not the case for the Highly Indebted Poor Countries, who have some of the highest levels of resource wealth. Evidently, corruption is the responsible actor for the break in the resource-wealth logic model. Nigeria, for instance, received \$22 billion in oil and gas revenues in 2002, yet it ranked 140th out of 157 countries in regards to wealth, and had a per capita income of less than \$900. This is in stark comparison to Norway, which ranked 3rd out of 157 and roughly received \$30⁷ billion in oil and gas revenues in 2002, and had a per capita income of approximately \$30,000⁸. The most disheartening story is that of the Democratic Republic of Congo, which in 2004 earned close to \$1 billion in oil revenues, and yet was one of the poorest and most indebted countries in the world:⁹ it ranked 189th out of 192 countries in terms of wealth, with a per capita income of \$633.¹⁰

The Global Forum Policy organization noted that many academic studies have shown that countries highly dependent on natural resources for their revenues often score low on the United Nations Human Development Index, have larger shares of their population in poverty, and exhibit higher levels of corruption. The reasons for the resource curse stem from the

⁶ Culverwell, Malaika, Bernice Lee and Izabella Koziell. “Towards an Improved Governance Agenda for the Extractive Sector.” The Royal Institute of International Affairs Report: Sustainable Development Program (2003): 7.

⁷ Society and Policy: Norway, an Oil Nation. Norway: The official site of the UK. ed. Norwegian Ministry of Foreign Affairs. (2007): accessed at <<http://www.norway.org.uk/policy/trade/oil/oil.htm>>

⁸ Economy Statistics: GDP per capita. Nationmaster. (2007): accessed at <http://www.nationmaster.com/graph-b/eco_gdp_ppp_cap>

⁹ “The Riddle of the Sphinx: where has Congo’s oil money gone?” Global Witness (December 2005): 1, accessed at <http://www.osisa.org/files/transparency_cd/global%20witness/The_Riddle_of_the_Sphinx.pdf>

¹⁰ Economy Statistics: GDP per capita. Nationmaster. (2007): accessed at <[http://www.nationmaster.com/encyclopedia/List-of-countries-by-GDP-\(PPP\)-per-capita](http://www.nationmaster.com/encyclopedia/List-of-countries-by-GDP-(PPP)-per-capita)>

misappropriation of natural resource revenues by corrupt leaders and officials, instead of those funds being used to promote economic growth and development for the country and its citizens.¹¹ However, transnational enterprises play an increasing role in the corrupt activities that undermine the economic health of developing countries.

THE POSITION OF TRANSNATIONAL ENTREPRISES IN THE PARADOX

Terry Karl declares that the factors that contribute to high levels of corruption in resource-rich developing countries are due to the fact that much of the world's natural resources "lie outside advanced industrialized democracies under the control of states where the rule of law is frequently weak; administrative capacity is undermined by civil service recruitment based on patronage rather than merit; and authoritarian regimes tend to prevail."¹² As a result, the public sector in the various resource-rich developing countries becomes vulnerable to private-sector capture and corrupt state officials.

However, it takes two to tango. Inasmuch as weak governments gives rise to corrupt activities by high level officials in these countries, the activities are abetted by transnational extractive industries who themselves do not report on revenue payments made to developing governments or on the level of productivity they have in their host country. Consequently, the non-transparent activities of transnational extractive industries in developing countries does as much to undermine the internationally advocated principles of good governance as does the actions of state officials themselves.

¹¹ Palley, Thomas I. "Lifting the Natural Resource Curse." Global Forum Policy: Foreign Service Journal (December 2003): accessed at <<http://www.globalpolicy.org/security/natres/generaldebate/2003/12curse.htm>>

¹² Karl, Terry Lynn. "The Oil Trap." Transparency International Quarterly Newsletter (September 2003): 9.

While it is difficult to quantify the impact of corruption between transnational resource exploitation companies and governments because of the lack of transparency, Transparency International's Quarterly Newsletter in 2003 was able to make mention of some specific cases that were under some form of examination. For instance, James Griffin, an American businessman, was under investigation in 2003 for organizing payments of more than \$1 billion from Exxon Mobil, British Petroleum, Amoco, and Philips Petroleum to President Nursultan Nazarbayev and other senior officials of the Kazakhstan government. A subsidiary of Haliburton, the major American oil company formerly owned by U.S. Vice President Dick Cheney, has also admitted to paying millions of dollars to Nigerian officials in exchange for corporate tax breaks.¹³ The most demoralizing element of all these incidents is that billions of dollars were lost in revenues in countries where as much as 70% of the population lives in abject poverty on less than \$1 a day.¹⁴

In 2005, the British-based NGO Save the Children came out with a report entitled, *Beyond the Rhetoric – Measuring revenue transparency: Company Performance in the oil and gas industries*, which analyzed and ranked the operations of twenty-five transnational oil companies in Angola, Azerbaijan, Timor Leste, Indonesia, Nigeria, and Venezuela. The companies examined in the report included: UK based British Petroleum, Dutch based Shell Corporation, China based PetroChina, and American based ExxonMobil, Unocal Corporation, and TransAtlantic Petroleum Corporation. The report examined three areas to ascertain whether or not oil extractive industries were doing their part in increasing the transparency of their activities in areas regarding: 1) disclosure of revenue payments to the host government in the

¹³ Karl, Terry Lynn. "The Oil Trap." Transparency International Quarterly Newsletter (September 2003).

¹⁴ Ibid.

developing country; 2) disclosure about the total volume of oil extraction in the country; and 3) company policy regarding whistle-blowing of corrupt practices between the extractive industry and the host country.¹⁵

Specifically, in the first category, revenue payment transparency addressed the disclosure of production entitlements, royalty payments, taxes, bonuses, and fees. The second category, supportive disclosure, estimated the disclosure of general information regarding global and local corporate structures; current and future volumes of production; the quantity and value of reserves; and company revenues, costs, and profits. This category is similar to the final report that transnational companies would prepare for their home government. In the third category, anti-corruption and whistle-blowing ascertained the company's propensity to transparency and good governance practices by examining the company's policy regarding the corruption and the condemnation of employees that violate these policies.¹⁶

The overall results of the study were fairly disappointing. Fifteen out of the twenty-five companies evaluated gave no reports as to the revenue payments made to the host government of the country they were working in. Furthermore, many companies typically reported on revenue payments made to regional areas and not to specific countries themselves, which makes it difficult to directly evaluate their activity on a per country basis. While disclosure of companies' productivity and structure yielded better results than the transparency of revenue payments, reports remained largely cumulative, noting results on regional rather than on a country-by-country basis. Results examining the anti-corruption policies of transnational oil countries were

¹⁵ "Beyond the Rhetoric – Measuring Revenue Transparency: Company Performance in the Oil and Gas industries." UK Save the Children. (2005): accessed at <http://www.publishwhatyoupay.org/measuring_transparency/pdf/companies.pdf>

¹⁶ Ibid.

the most positive with thirteen out of the twenty-five countries scoring above 70% in regards to their sound policy and management systems.¹⁷ However, these scores are based on the content of the anti-corruption policies and not on whether or not these policies were actually implemented.

POLICY RECOMMENDATIONS

Lifting the resource curse will necessitate the collaboration of both national structures within resource-rich developing nations and international assistance to support such endeavors. On an endogenous level, resource-rich developing nations should look to strengthening their judicial institutions so that they have the capacity to address the corrupt practices of international business in a punitive context. Fostering a strong and independent system of justice will increase the ability of resource-rich nations to make and implement rulings that penalize nationals who participate in business activities that undermine a country's economic well-being. Specifically, it is recommended that resource-rich countries execute the following policies to strengthen and increase their capacity and reduce corrupt practices:

- Create a process to independently appoint judges that would enlist the participation of multiple sectors of government to ensure a division of power in judiciary appointments.
- Tighten constitutional and/or national laws that relate to business transactions of extractive resources so that prosecutors have the power to punish wrongdoings in international business transactions.
- Increase the technical capacity of judicial systems by creating an oversight agency to track and monitor the transfer of revenues in business transactions involving extractive

¹⁷ Ibid.

resources. This will ensure that judges and lawyers will be able to identify and prosecute unethical or inappropriate transactions that are a result of corrupt activities.

By providing the necessary tools needed to empower the justice system, judges and prosecutors in resource-rich developing countries can effectively act against those who are directly involved in business transactions that embezzle much-needed resources from the greater society.

Given that corruption is a global problem, international assistance is also needed in efforts to successfully strengthen the judicial institutions in resource-rich developing countries. Legal assistance measures should be carried out on the international level to support the endeavors of resource-rich developing countries who seek to improve their system of justice, consequently strengthening their rule of law. In addition, developed nations need to establish more stringent oversight of the activities of their transnational enterprises in resource-rich countries, and punitive policies to prosecute those enterprises whose international business practices are corrupt. It is important that developed nations set up a system of controls to prosecute their own nationals who participate in corrupt practices that undermine the international community's efforts of ethical business relationship because as noted by Akere Muna, Vice Chair of Transparency International, "Criticism by rich countries of corruption in poor one has little credibility while their financial institutions sit on wealth stolen from the from the world's poorest people."¹⁸

¹⁸ "Persistent Corruption in Low-Income Countries Requires Global Action." Transparency International Press Release 2007 (9 September 2007): accessed at <http://www.transparency.org/news_room/latest_news/press_releases/2007/2007_09_26_cpi_2007_en>

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