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Ensuring Fairness: The Case for a Transparent Fiscal Social Contract
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Resource Curse

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Chapter 10: Ensuring fairness? The case for a transparent fiscal social contract

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Abstract

The 'resource curse' is primarily a political and not an economic phenomenon. In this chapter I identify the key features of dependence on natural resource rents that produces the political problems. On the one hand, the exceptional value of their leading commodity has meant *unusually high levels of external intervention* in shaping their affairs and capturing their resources by dominant states and foreign private interests. On the other hand, petro-states are even *less subject to the types of internal countervailing pressures* that helped to produce bureaucratically efficacious, authoritative, liberal and ultimately democratic states elsewhere *precisely because they are relieved of the burden of having to tax their own subjects.* Many of the solutions that are commonly proposed fail to take account of these basic dynamics. What is needed first and foremost is a far-reaching "fiscal social contract" based on transparency -- one that creates incentives to change the rent-seeking behavior of all actors, both international and domestic, involved in the oil game.

Introduction

The 'resource curse' in oil-exporting countries, a catchall phrase capturing the perverse development outcomes linked to petroleum,[1] is primarily a political/institutional and not an economic phenomenon -- a fact that most policymakers have been slow (or perhaps unwilling) to grasp.[2] The resource curse cannot be attributed to oil itself, which is merely a black viscous material, but rather to the types of arrangements that have developed around its exploitation. Nor can it be attributed to the mere possession of petroleum; for the full panoply of resource curse consequences to appear, petroleum must be sold in the international market and not used solely for domestic purposes.[3] Moreover, the resource curse is due as much to the nature of the international oil regime -- meaning the institutions shaped by multinational oil companies, their host governments, and foreign lenders -- as it is to the structures of states and private actors in oil exporting countries -- another inconvenient reality that is often not addressed.

Simply stated, petroleum dependence turns oil states into 'honey pots' -- ones to be raided by all actors, foreign and domestic, regardless of the long-term consequences produced by this collective rent seeking. In computer terminology, a honey pot is a trap that poses risks to an entire system if it is not appropriately contained. The analogy is appropriate: the pursuit of oil rents by both domestic and international actors has produced an "oil trap" -- one that not only threatens the economic and political stability of petro-states but also the health of the international economy and the prospects for a more peaceful world. Because the roots of this trap are largely political and institutional, overcoming the perverse impacts of oil-led development must begin with political and institutional agreements. As we shall see, this requires a 'big push' in the direction of a far-reaching "fiscal social contract" based on transparency -- one that creates incentives to change the rent-seeking behavior of all actors, both international and domestic, involved in the oil game. The initial step in this fiscal social contract is in effect a broad-based agreement among nations and their citizens, companies and international financial institutions to be more open about the allocation of oil rents so that their distribution can become fairer. This would also permit the eventual transition to alternative energy forms to be made in a more orderly and less

conflict-laden fashion. Its outlines are already discernible in the emerging convergence over the importance of transparency as a first step for overcoming the resource curse.

Whatever the past benefits of relatively cheap energy, current arrangements in the oil sector are now associated with so many harmful outcomes that they must be changed. The list of costs to the oil-exporters speaks for itself: slower than expected growth, barriers to economic diversification, poor social welfare indicators, high levels of poverty, inequality and unemployment, higher than average corruption, poor governance, outright authoritarian rule or its omnipresent threat, weak rule of law, a culture of rent-seeking, often devastating environmental damage, human rights violations and greater risks of conflict and war.[4] These results are not confined to the world's hotspots like Iraq, Indonesia, Sudan, Chad, the Niger Delta and Colombia but also extend to countries attempting to manage serious domestic cleavages like Venezuela, Iran and Saudi Arabia. Today, at least 34 less-developed countries rely on oil and natural gas for at least 30 percent of their export revenues, and over one-third of these countries have annual per capita incomes below $1500 (Birdsall and Subramanian 2004). Almost all of the latter group and many of the former are potential or actual failing states.

The imperative for reform is also underscored by the ever more obvious costs to the consuming countries. This is apparent not only through significantly higher prices at the pump and growing concerns about inflation and recession but also through the politically uncomfortable juxtaposition of these prices with skyrocketing company profit.[5] Furthermore, with 2005 ranked as the hottest year on record and increases in the intensity of and damage caused by dramatically shifting weather patterns,[6] the fear of global warming linked to fossil fuels is more real every day. The concern with 'peak oil'-- the notion that the height of discovery will soon be (or has been) reached and will inevitably decline -- exacerbates these worries. These trends are just now being felt, but there is certainly worse to come. The war in Iraq, a potential nuclear threat in Iran (for which sanctions might push up prices to $100 per barrel), and the growth of terrorism fueled by energy-related grievances or paid for by oil purchases are urgent signs of a brewing fossil fuel crisis. [7] If this crisis is not managed with planning and anticipation, it is likely to pose a grave threat to the entire world.

Still, even with these alarming prospects staring the petroleum sector in the face, arriving at a social contract for curtailing rent seeking, the main cause of the resource curse, will not be easy. Nor can this be the province of technocrats alone. The efficacious use of petroleum wealth and the fair division of oil rents is, at heart, political -- a question of power, bargaining and social justice. As we shall see, the resource curse is the manifestation of such long-standing and institutionalized patterns that it cannot be undone without a huge coordinated effort by all the stakeholders involved -- including the governments and citizens of producing and consuming countries, international oil companies, and international financial institutions -- to design new norms and practices for energy production.

This chapter explores the need for what Moore (2004) has called a fiscal social contract and what I have elsewhere referred to as pact-making to improve governance in the petroleum sector (Karl 1982). To explain the roots of the resource curse, it focuses on an argument first presented in *The Paradox of Plenty* (Karl 1997) about the political and organizational consequences, both nationally and internationally, of relying upon petroleum revenues rather than direct taxation for the development of stateness in oil-exporting countries. It then reviews some of the proposals for ameliorating the resource curse showing that, whatever their strengths, *they can only work where rent-seeking has been identified, made transparent, and becomes an issue of monitoring and open political debate*. This is especially true in those countries where kleptocracy is most often the rule and not the exception, for example, West Africa and the Caspian Basin. Finally, this chapter highlights the outlines of the first essential step in overcoming the resource curse -- what is becoming an emerging social contract involving transparency and the monitoring of oil revenues at the international and domestic levels.

Diagnosing the problem: the state as 'honey pot'[8]

"The revenue of the state is the state," said Edmund Burke, and this is precisely the dilemma of oil-exporters.[9] Scholars of state-building, whatever their differences, agree that capable states are built through bargaining with other states, on the one hand, and bargaining with organized groups within their own territory, on the other. State authority is historically constructed and maintained through a series of exchanges of resources for institutions (Tilly 1975, 1992). Because oil states support themselves through *rents*, or what Adam Smith

described as 'activities of people who reap what they do not sow,' these exchanges are significantly delayed and skewed, or they must occur through other mechanisms.

Dependence on rich mineral endowments, when aimed for export, generally makes for poor institutions, especially those institutions that deal with state administration (e.g., civil services) or political representation (e.g., political parties). In effect, these institutions are the intermediate causal link between the exploitation of resources and the quality of economic performance. Petro-states suffer from a double perverse effect: their states, so often formed during the period of oil extraction, are skewed by the imperatives of resource extraction, but the intensification of the resource dependence that accompanies state-building subsequently produces even further decay in critical arenas such as non mineral-based revenue raising, expenditure patterns, fiscal accountability and citizen participation. A vicious cycle between mineral extraction and state making is set in motion. Even though many other factors unrelated to petroleum dependence affect state-building, these other factors are generally not strong enough to counteract this 'oil effect.' In the best cases, mineral dependence initially contributes to some form of state-building, but even here, the public sector eventually becomes a 'honey pot' that lends itself to state capture to the detriment of the state's efficacy, representative capacity and sustainability.

In the short to medium term, oil-based revenue raising and resource allocation tend to support whatever type of government is in power as petrodollars come on stream. This is why some stages of oil dependence have been marked by unusual regime longevity, some by uneven forms of state-building and stability; witness, for example, the rule of Iraq's Saddam Hussein, Indonesia's Suharto or Saudi Arabia's royal family. But eventually, (and often immediately in the worst cases), kleptocracy comes to rule, development possibilities are horrifically squandered, opposition rises and regimes eventually cannot be stabilized, producing a higher propensity in oil-exporting countries for conflict and war. In this respect, oil regimes as a whole are marked by an unusual 'paradox of plenty:' they are simultaneously more stable and more prone to conflict.

A contrast with state development in Europe best makes the point. In the European experience, state building[10] arose primarily from the long and violent struggle to define

national borders – a struggle that ultimately required taxation (Tilly 1975, 1992). The development of the modern state paralleled the growth of permanent standing armies because any state that wished to survive had to increase its extractive capacity to pay for its protection; war generated an increased need for revenues that could only be met through taxation or borrowing. Because taxation often provoked costly and violent resistance, and borrowing depended on the ability to demonstrate a secure revenue base, regimes had to invest real political and organizational effort into developing linkages with their subjects in order to raise the revenues they needed. In this respect, states became motors of change. Rulers learned that using consensual mechanisms for extracting taxes was in their interest in the end, even if this meant increasing revenue transparency, submitting to oversight in the revenue-raising and public spending processes, and giving taxpayers a say in how their monies were spent. The net result was the construction of an administrative apparatus that could penetrate the national territory, the creation of merit-based civil services, the evolution of the rule of law to ensure compliance on all sides, and the facilitation of some type of representative institutions that could provide for some citizen input.

In effect, an eventual fiscal social contract was achieved between those who provided taxes or loans and those who had the power to give constitutional promises of consultation and respect for the rule of law.[11] This changed what could have become a catastrophic stalemate between rulers and their subjects into a win-win situation, producing a virtuous cycle between political institutions and economic patterns. Bureaucracies became repositories of knowledge that could facilitate better public policy and more informed political debate. Furthermore, once a more routinized, predictable and consensual state apparatus was in place, lending to the state became more attractive to financiers. This helped to increase state capacity since greater access to borrowing was tied to, and not disconnected from, performance. States with strong taxation mechanisms were able to depend on loan financing in addition to their tax revenues because they could leverage their revenue-raising capacity to borrow money, both domestically and abroad. Thus arose what Moore (2004) calls the first modern fiscal states.

States in the developing world, and especially petro-states, have had a very different experience. Not only have most been created with artificial borders and/or a prolonged

history of direct or indirect external control, but they have all emerged into an international environment already dominated by rich and powerful states driven by their own interests. Thus, the construction of state authority has been strongly shaped by international power asymmetries that were qualitatively different from those in Europe. Conquest may have facilitated the eventual drawing of boundaries, but it disrupted the tight cycle connecting state-making, war, taxation and borrowing at the expense of the institutionalization of authority and the administrative differentiation of control. Because mineral states in particular were not built through direct taxation, the pressures for rule of law and more fair distribution, so present in Europe, were especially weak. Not only were such states bureaucratically anemic and lacking in transparency, but they were also especially vulnerable to state capture by private foreign and domestic interests. Under these circumstances, economic outcomes were marked by a continuing vicious cycle of poverty and inequality (Karl 2000).[12] That the resource rich exporting countries of Latin America, the Middle East and Africa historically lacked the "stateness" characteristic of their resource poor Asian "tiger" counterparts is another counter-intuitive aspect of "the paradox of plenty."

Within the category of resource-rich exporting countries, petro-states are a special, and in this respect an especially unfortunate, subset. While they may share properties with other states in the developing world in that their revenues do not originate from taxing their subjects, oil states are different because of the qualitatively greater scale and duration of their 'unearned income.' They are "rentier" states *par excellence*—states that rely to an unusually great extent on externally generated revenues.[13] This has two broad developmental effects. On the one hand, the exceptional value of their leading commodity has meant *unusually high levels of external intervention* in shaping their affairs and capturing their resources by dominant states and foreign private interests. On the other hand, petro-states are even *less subject to the types of internal countervailing pressures* that helped to produce bureaucratically efficacious, authoritative, liberal and ultimately democratic states elsewhere *precisely because they are relieved of the burden of having to tax their own subjects.*

The unusual degree of external pressure is most evident in the revenue imperative. The history of petroleum is the story of geopolitical maneuvering around the lifeblood of the industrialized world, and oil and war have been linked since the beginning of the 20th century

(Yergin 1992, Klare 2004, Kaldor, Karl and Said 2006). This is not true to the same extent for any other commodity. The industrialized states have always pursued their own vital interests in securing supplies and ensuring that no single country can dominate the production of supplies, backing their own multinational energy companies to the hilt. The companies, in turn, wield their clout to maximize their own benefits, in large part by shaping the regulatory environment in their own interests rather than for the long-term benefit of people living in oil-exporting countries. At the same time, however, oil governments have always had a certain advantage when it came to international financial institutions. Because borrowing by petroleum-exporting countries is a type of 'strategic rent'[14] in that it supports status quo rulers who can use future barrels as collateral, lending has most often taken place without strict conditionality and under more favorable circumstances than are available to other developing countries. Thus borrowing becomes an attractive substitute that permits politicians to avoid domestic taxation. The allocation of oil rents between countries and companies depends on the capacity of petro-states to redress this company/country balance of power. Observe, for example, the difference in the mere seven percent of revenues that accrued to Chad in its earliest contracts compared to the approximately ninety percent of revenues going to the more experienced and capable petro-states.

This unusually high external profile encouraged a qualitatively different 'resources for institutions' bargain, this time between rulers and international actors. External dominance and control of capital and technology has meant that oil governments have engaged first and foremost in negotiations with foreign companies instead of bargaining with their own populations. For different reasons, both rulers and companies historically favored strong centralized authority. The net result in most oil-exporters was a marriage of convenience between companies and rulers, based on extreme over-centralization and concentration of power – with little incentive on either side to change the system. True, this marriage was filled with perpetual tension, especially when oil states faced powerful demands from their own citizens to capture and distribute more petrodollars or to nationalize foreign companies,[15] but with, few exceptions, rulers learned (sometimes by seeing their stubborn counterparts removed elsewhere[16]) that it would be difficult to remain in power without some form of *modus vivendi* with multinational companies. While bargaining between companies and governments became increasingly more complicated as internal

constituencies became more mobilized and regimes more democratic (as contemporary events in Nigeria, Venezuela and Bolivia demonstrate), it remains the decisive mechanism for revenue raising.

Not surprisingly, then, oil-based regimes eventually developed a differentiated and efficient bureaucratic apparatus in the areas necessary to extract revenues from the international oil industry, especially in powerful energy ministries and national oil companies. Propelled by their particular form of revenue imperative, petro-states have been organizationally innovative in the international arena, especially through the formation of the Organization of Petroleum Exporting Countries, sophisticated contracting arrangements, and other mechanisms to increase their take of oil rents.[17] But these externally oriented bureaucracies, however capable, cannot play the same role as efficient and merit-based civil service organizations aimed at extracting revenues from their own population, managing territorially comprehensive tax systems, and subsequently directing resources where they should go. While they may be important repositories of skills and knowledge in some cases,[18] such bureaucracies are significantly smaller in size and limited in their range of expertise and territorial reach.

The reliance on this unique revenue source also created especially distributive expenditure patterns, producing the *ne plus ultra* of the 'no tax and spend' state. Because governments in petro-states have their own guaranteed source of income, they have revenue autonomy from their subjects, an unusual degree of independence, and the power to decide who gets what from oil rents inside the national territory. As long as oil revenues are available in sufficient quantities (meaning that downward price trends do not last overly long), it is most efficient to allocate petrodollars in a fairly predictable pattern: buying off powerful groups and individuals so that they do not become a threat, permitting some degree of trickle-down, and building powerful coercive apparatuses to ensure compliance from their subjects. This appears to be precisely what occurred until the late 1990s in the OPEC countries when approximately 65-75 percent of the post 1974 gross domestic product was for public and private consumption, largely through subsidies to friends, family and political supporters of the government.[19] The remaining portion (20 to 35 percent of

national output) was either invested or used to build sophisticated militaries for national defense or for the suppression of opposition movements.[20]

Such distributive patterns, so obviously detrimental to the economy, also have harmful impacts on state structures. They foster a widespread culture of rent seeking as a wealth creation strategy, not only among public officials and private interests but also within the entire population. Moreover, since merit-based civil service and monitoring systems with their concomitant public service values were never firmly established, there is very little -- apart from religious or ideological networks -- to counteract widespread rent seeking. Patronage and corruption become the name of the game, and when revenues are scarce, a type of "rentier borrowing" can fill the void. The result is evident. Because petrodollars are not 'their' money, citizens are not motivated to ensure that state revenues are well spent; they are not engaged; and they seldom demand better monitoring of the utilization of revenues. Like their rulers, they too often become addicted to their share of oil rents even as a type of permanent disconnect between the state and its subjects sets in.

Thus, while petro-states may look strong, the impact of reliance on petroleum rents is gradually devastating. Because these states tend to substitute the distribution of rents for more enduring forms of statecraft, they appear large and powerful, but they are hollowed out. Not only do governments have strong political incentives to undertake inefficient distribution, they lose the potent brake of scarcity – one of the chief motors of innovation. This is especially the case during boom periods, ironically the most dangerous time for oil states.

Over time, petro-states suffer from at least three types of "stateness" deficits: information, monitoring and participation.[21]

- The *information deficit* arises from the absence of a robust tax bureaucracy, the dearth of feedback mechanisms that are derived from citizen payment of taxes, and, as we shall see, the general opacity of the industry itself. This means that oil governments are denied crucial knowledge showing, for example, the types of successful businesses that should be promoted or how patterns of income distribution are changing; at the same time, without this sort of information, citizens have virtually

no viable way of assessing whether their own demands on the state or the government's expenditure patterns are reasonable or effective.

- The *monitoring deficit* originates from the lack of a revenue incentive to develop or comply with regulations on the part of economic producers; it is exacerbated by the acute over-centralization of power within the executive that makes it difficult to construct meaningful checks and balances, and in the case of the energy sector, by the enormous capacity of multinational energy companies to prevent or circumvent regulations, both in their home and host countries.
- The *participation deficit* comes to pass in a myriad of ways but most especially from the lack of connection between subjects and the state, which breaks any sense of ownership of public resources or consequent citizen engagement. This fosters a rentier culture because citizens tend to track governments less when they are untaxed and rulers have less interest in the productivity of their subjects when they do not depend on these activities for raising revenues.

Together, these three deficits effectively remove any effective form of fiscal accountability in oil-exporting countries. They also weaken efforts to hold foreign and national energy corporations accountable for their activities inside petro-states, most especially with regard to environmental damage and impacts on local communities. Whatever the type of regime in place, building better governance both within oil states and in the international petroleum sector rests on addressing all three of these deficits.

Market failure and state failure: The costs of business as usual

Opacity is the glue holding together the patterns of revenue extraction and distribution that characterize petro-states as well as the entire international petroleum sector. Companies do not publish what they pay to states, and states do not disclose what they earn and spend. Neither concessionary nor the more common contractual systems are transparent; governments, for their part, do not even provide the most basic information about their revenues from their natural resources. There is no transparency regarding the amount of resources available to be exploited, their rate of exploitation, the funds that governments actually receive, and the uses to which these funds are put. Indeed, concealing information,

hiding output plans and price objectives, refusing to be transparent about how governments interact with those involved in the extraction of oil, and using confidentiality clauses to obscure the content of signed contracts has been the name of the game. Thus huge amounts of money are virtually untraceable and not subject to any oversight.

The 'marriage of convenience' between oil countries and companies means that obscuring information is not difficult. The short-term advantages of doing so are readily apparent. For the companies, for example, confidentiality shapes how they account for their costs, what profits they report, how much profit tax they must pay to governments, whether they can offer large signature bonuses or side payments to enhance their competitive advantage in a country, and even how they interpret or indeed whether they can veto environmental or human rights standards. For oil governments, opacity affects the kinds of contracts they enter into, the amount of revenues they receive and whether these funds are ultimately traceable, and the types of security or environmental standards they do or do not defend. But in the longer run, opacity is a formula for corruption and concomitant development disaster. As long as authorities have the power to permit one firm to enter their country ahead of others (for a price) or set up bonus bidding to require companies to compete on the basis of how large an up-front bonus they will pay, these practices ultimately discourage competition and result in lower revenues over time for the nation as a whole. Opacity simply means that enormous sums of money are passed around, both internationally and domestically, without the most basic forms of accountability.

The failure to recognize and remedy this problem may mean that all of those involved believe that the lack of transparency serves their interest (and this is certainly the case for a small number of actors), but the reality for most stakeholders is quite different. The information deficit, not only within petro-states but also in the entire industry, encourages increasingly problematic market failures and dangerous state failures, which in turn reinforce each other through feedback mechanisms. Thus, current arrangements in the oil sector are producing too many losers worldwide -- and threaten to produce even more in the future.

The cost of oil price volatility, which is twice as variable as other commodities, is a case in point (Aizeman 1999, Karl 2004). Beginning in 1973, prices began to experience more rapid and greater fluctuations, and this volatility has accelerated exponentially (on the downside and the upside) after the collapse of OPEC's administered pricing in 1985.[22] Volatility is directly related to the lack of transparency, including OPEC's failure to publish field-by-field oil production data,[23] the extraordinary secrecy of the only swing producer, Saudi Arabia, and the extensive speculative activities encouraged by industry secrecy. The information available to economic agents, including the companies, countries and traders, is so poor[24] that the responses to this information, which determines future price formation, often has little relationship to actual economic conditions.[25] When added to the reality that the actions of a small number of very powerful and sophisticated players can cause prices to move in different directions, economic fundamentals become only one determinant in the price equation, causing still higher volatility. In effect, *prices are robbed of their most basic function* -- serving as signals of the demand/supply balance. While this price failure affects everyone, especially as the shifting cost of fuel works its way through a global economy, its impact is asymmetrical: a fifty percent increase in the price of oil might only cut the US GDP by half a point, but the same changes will cause severe contractions or overheating inside oil-exporting countries. Volatility's boom-bust cycles exert a strong negative influence on planning, budgetary discipline and the control of public finances, meaning that economic performance may deviate from planned targets by as much as 30 percent. Price fluctuations are also detrimental to investment, income distribution and, most important, the alleviation of poverty inside oil exporters.

Opacity has other severe costs. While policy failure is to be expected in states subject to very rapid, unpredictable and often wild price fluctuations, their lack of information about projected revenues and their own past expenditures makes such failure even more likely. This is most evident in the loss of fiscal control manifest after the booms of 1973 and 1980 (and surely to be manifest in the current boom), which ultimately produced absorption problems, rampant rent-seeking, overheated economies, widespread inefficiencies, extensive waste, spiraling subsidies, and over-borrowing likened to that of "drunken sailors in a bar."[26] The result is the astonishing loss of a unique development opportunity. Petro-states, including Algeria, Angola, Ecuador, Gabon, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar

Venezuela and Trinidad-Tobago, experienced real per capita income plunges back to levels of the 1960s and 1970s. In Saudi Arabia, where oil reserves are (reputedly) the greatest in the world, per capita income dropped from $28,600 in 1981 to $6800 in 2001 (Karl 2004).

Astounding heights of corruption (and widespread smaller levels that are difficult to entangle from "normal" rent-seeking) form the capstone of these economic outcomes. The stories are legendary: In Angola, where Global Witness (2004) reports that a billion dollars a year representing about a quarter of its oil revenues disappears, President Dos Santos keeps large sums of money in secret bank accounts while 70 percent of Angolans live on less than a dollar a day; in Kazakhstan, President Nazarbayev has secreted over a billion dollars in a secret fund in Switzerland and the largest foreign corruption investigation in U.S. legal history has uncovered kickbacks received from both Chevron and Mobil; in Equatorial Guinea, major U.S. companies pay revenues directly into a Riggs bank account under President Obiang's direct control; and in Congo Brazzaville, Elf Aquitaine (not Total) financed both sides of the civil war and helped to mortgage the countries future oil income in exchange for expensive loans. As Global Witness (2004) demonstrates, *none of these scandals could have happened if oil companies had been forced to disclose publicly their resource payments to petro-states.* This corruption raises the transaction costs of doing business in oil-exporting countries, negatively influences the amount of foreign direct investment, lowers the productivity of infrastructure expenditures, affects decisions about which projects to undertake, and is negatively correlated with foreign currency credit ratings, thereby damaging future performance (Sutton 2005). In the end, countries that fall at the bottom of Transparency International's corruption scale, and this includes almost all oil-exporters, generate socioeconomic conditions that fuel social unrest and have more internal and external conflict.

That such outcomes generate deep and escalating grievances should not be a surprise. Both booms and busts produce intense social, identity-based and generational tension, especially when the huge in-migrations associated with oil production add different nationalities, religious identities and political beliefs to the mix.[27] In petro-states, this is exacerbated by sharp cleavages created by a highly visible (most often) foreign industry associated with the West and unusually noticeable extremes of wealth and poverty in what is

widely perceived to be a rich country. The first point of grievance is most often the regions where oil fields are found because oil exploitation affects every environmental medium – air, water and land – and can endanger the health and livelihoods of communities located near installations and pipelines.[28] While these regions feel the greatest effects, they tend to get the least rewards; they suffer from lower economic growth, higher inflation, greater dislocations[29] and lower per capita income – all in the context of higher expectations. When communities protest, most regimes, whether authoritarian or democratic, respond with force, as government-sponsored public or private security forces act to protect oil operations and the future revenues of the state. Perhaps the best-known instance is Nigeria's Niger Delta, where once thriving and self-supporting villages have been made unlivable, security forces have caused severe human rights abuses, and communities have few ways to seek redress – except by holding hostage the producers and the production of oil (Human Rights Watch 1999). [30] This is a formula for almost permanent instability, violence and eventually, civil war and state failure.

Petro-states may appear to be remarkably stable in the face of such challenges, and indeed their regimes, whether authoritarian or democratic, often last an unusually long time. But this is a hollow stability. Their deficits of information, monitoring and linkages with their populations mean that change, when it comes, is not likely to be reformist and incremental. Instead, the unexpected ousting of Iran's powerful Shah or the sudden collapse of the party system in Venezuela portends the types of dramas waiting in the wings. In the best case scenarios, oil states already have enough stateness in place that they can manage to reconstitute themselves after such challenges, as Venezuela and Nigeria are trying to do. But when states are already exceptionally weak or have been virtually destroyed, this portends the proliferation of more failed states. In turn, each regime change or conflict in an oil-exporting country sparks new volatility in oil markets with greater prospects for global inflation and recession as well as more fiscal chaos inside the exporters themselves. This foreshadows new failures down the road. Thus the bundle of price volatility, global economic difficulties, environmental damage, authoritarian responses, state failures and increased conflict is the Achilles' heel of current arrangements, and is increasingly putting the entire industry under scrutiny.

Why technocratic fixes cannot be the first step

Avoiding market and state failures has become the rhetorical stance of all actors in the oil story, and the range of prescriptions offered is wide. According to economists, petro-states should diversify away from oil and use market mechanisms (including a liberalized trade and exchange regime, privatization and deregulation) to guarantee macroeconomic stability. To prevent the Dutch Disease (see Chapter 1), they ought to improve productivity in agriculture and industry and reform their financial sectors. They should "sterilize" their petroleum revenues by saving them in an oil trust fund abroad, thereby avoiding overheating by introducing them gradually into the economy. They should cut public spending and avoid popular public works programs with immediate payoffs. Finally, they should provide a stable environment of property rights and drastically limit their own role, possibly by privatizing the petroleum industry. And they should do all of this while improving their judicial systems to better fight corruption. In short, petro-states should simply remake themselves.

But such prescriptions do not take into account a fundamental reality: *what is often economically inefficient decision-making is an integral part of the calculation of rulers to retain their political support by distributing petrodollars to their friends, allies, and social support bases.* Nor do they recognize that such far-reaching economic reforms can seldom be accomplished short of massive and sustained external conditionality, which is especially unlikely in oil-exporting countries. Rulers have every reason to engage in the political allocation of petro-dollars and face no immediate incentives to be frugal, efficient, and cautious in their policy making. And they have no reason to decentralize power voluntarily to other stakeholders. Rather than checking the rising dominance of the state over the economy (as neo-liberals advise), avoiding the hasty industrialization, profligate overspending, and increased domestic consumption that has marked the OPEC countries (as development economists advocate), or promoting judicial reform, financial transparency and "good governance" (as both USAID and the World Bank urge), political leaders seem to believe that they can ward off immediate political and economic problems by doing precisely the opposite. This is not because leaders do not understand what might be in their own interests; rather, at least in the short run, they may understand only too well.

This is why many of the solutions proposed for overcoming the resource curse, which seem so very promising, are unlikely to work on their own and, instead, should be put forward as part of a larger process of political reform. Virtually all of these proposals are only economic and technocratic, and they are aimed solely at petro-states themselves rather than the symbiotic relationship between these states and the oil companies. To be effective, they most often rest upon extensive information, monitoring and participation generated by an environment suffused with respect for rights as well as the consent of the population. In sum, they require at least some of the very "stateness" that is lacking in oil-exporters. Even a brief look at these proposals demonstrates the importance of prior attention to addressing deficits in information, monitoring and participation before they can be successful.

"Sow the petroleum": economic diversification.

Perhaps the most obvious solution to the problem of the rentier state may be to diversify the tax base. Indeed economists have long argued that economic diversification, combined with better fiscal and monetary policies, can overcome the "crowding out" of other productive activities that petroleum dependence builds into the economy. By subsequently taxing these activities, this in turn could reduce the state's dependence on natural resource rents. But although this has been attempted in countries as different as Venezuela and Iran, this is unlikely to resolve the problem, at least not in the first instance. There are painfully few successful examples of diversification that can withstand the political impact of the withdrawal of huge subsidies and protective tariffs combined with increased taxation. While huge petrodollar flows perversely affect the productivity of non-oil activities, they have had the added drawback of encouraging huge industrial projects that can better hide revenue siphoning (leading to some rather astonishing "white elephants," most notably in steel and other forms of heavy investment). One central reason for the failure of such diversification is that oil-dependent governments have not combined these efforts of diversification with sound fiscal and monetary policy, thus they have been unable to mitigate the negative effects of boom/bust cycles. This budgetary instability means that in good times they are incapable of putting brakes on overspending, but in bad times they cannot stop over-borrowing.[31] The problem is that this remedy depends first and foremost on the information and monitoring

generated by merit-based civil service bureaucracies that can withstand the pressures of state capture. But this type of bureaucracy is precisely what is in short supply.

"Sterilize" or remove revenues through natural resource funds

A second solution might be to prevent governments from relying on resource rents by putting those rents beyond their reach and into a natural resource fund. Whether modeled after Norway's State Petroleum Fund or the very different Alaska Permanent Fund, such funds are viewed as an important fiscal tool that can aid in planning. However, these funds, as they have been constituted to date, have major drawbacks. Because they are generally not transparent, and the information regarding their allocations is not available to legislatures, the press, or NGOs, the types of accountability mechanisms that would ensure their proper functioning do not yet exist (for more on this issue see Chapter 8). Indeed, there is little point in talking about such funds in countries like Kazakhstan, Republic of Congo or Equatorial Guinea, where governments do not provide even the most basic information about their revenues from oil or gas. Furthermore, while these funds may look good on paper, they are almost always set up under the direct control of the executive and thus can constitute a type of parallel budget without controls.[32] This poses the danger of simply adding to fiscal chaos while becoming a second "honey pot." Finally, claiming that it is necessary to save oil money while simultaneously attempting to raise taxes is politically difficult in countries that have become accustomed to a rentier culture or whose populations live in acute poverty. Explaining the necessity of taxation requires information and open debate, and both are in short supply.

"Privatize": Reallocate rights to oil revenues.

A third way to prevent too singular a reliance on revenues earned directly from oil is to change the patterns of property rights either of the production process or over the ensuing revenues, for example through direct distribution. Changing the ownership structure of the production process might mean inviting significant foreign participation (Kazakhstan) or permitting domestic private interests to take over -- at least temporarily (Russia). But once again, the problem with these arrangements is political. Privatization raises the acutely

partisan question of who gets to be the new owner, and it runs counter to strong nationalist notions that the state is the guardian by right of oil wealth. Furthermore, where oil rents are concerned, there is still no evidence that domestic private oil companies are any better equipped to manage petroleum than their state counterparts (see Chapter 2).[33] Direct distribution to the population, modeled after Alaska, has its own problems; it threatens to abandon cherished public goods, e.g., school systems, healthcare while failing to create citizen engagement (see Chapter 9). Alaska itself is a prime example. The distribution of petrodollars to individuals has substituted for a broad-based tax system, a personal income tax, and even a sales tax -- and the results are classic: chronic budget deficits, public works projects that remain unfinished, lower than average productivity, and a pattern of favoring consumption over investment. Why should this be any different in countries with less educated populations, less rule of law, and less participation?

Perhaps any of these policies might work well if the state in question is Norway -- not war-torn Angola, post-communist Kazakhstan, or ethnically divided Iraq. Norway, which is held up as the example of "best practices," has avoided the worst manifestations of the resource curse. But it did so from a point of departure of an already high level of development, with a pre-existing merit-based, technically competent and honest bureaucracy, and a strong democracy. With information, monitoring and participation "stateness" mechanisms already available, it was able to hold a broad debate over the appropriate utilization of oil revenues, reorganize its Ministry of Industry, create the highly efficient Statoil, define explicit roles for public and private companies, sustain a diversified economy, rein in borrowing, and establish an oil fund invested abroad to sterilize excess revenues. It even protected the state's non-oil fiscal capacity by resisting the strong temptation to lower taxes and permit oil revenues to replace its normal revenue base. By bringing its oil fortune under strict control, it was able to ward off the insidious rent seeking that followed in the wake of oil discoveries elsewhere (Karl 1997). The result speaks volumes: in recent reports of the United Nations Human Development Index, Norway ranks as the number one country.

But Norway's main lessons for other oil-exporters could seem discouraging. However well it has performed under the pressures of oil wealth, even a technologically

sophisticated "civil service state" has faced serious difficulties controlling its oil rents.[34] Furthermore, Norway demonstrates that the problem of managing oil wealth is essentially a problem of historical sequence: good institutions must be in place *prior* to the exploitation of oil. Good governance, transparency and participation are *prerequisites* for the effective utilization of petrodollars to alleviate poverty and prevent conflict -- not the other way around. Where serious deficits exist that block the free flow of information, monitoring and the participation of the population, petrodollars simply cannot be spent efficaciously.[35]

The crux of the "oil trap" is this: it is a lot easier and faster to build a pipeline than an efficient and representative state. But since neither states nor corporations get to choose the historic sequence confronting them, what is on the table is identifying and devising the functional equivalent of crucial forms of stateness. Escaping the resource curse must necessarily target the basic historic deficits of petro-states that are also characteristic of the international environment in which they operate. This requires overcoming the informational, monitoring and participation deficiencies discussed above as a precondition for the appropriate functioning of the economic and/or technocratic reforms discussed elsewhere in this volume.

Moreover, there is an appropriate sequence for these efforts at state and industry reform: neither monitoring nor citizen participation can be effective without prior attention to the problem of information. This is why the emerging international convergence around the notion of transparency -- pushed from below by a coalition of several hundred NGOs with partners in the exporting countries and from above by the British government in particular -- is so promising. Transparency in itself is no panacea and we have yet to see how effective it can be at changing deeply entrenched institutions and habits, but what differentiates the transparency initiative from other proposals is its comprehensive focus, not only on petro-states but also on the entire network of norms and practices that sustains opacity. The belief is that transparency is the essential first step in a multi-dimensional strategy to counteract the resource curse. In effect, it is the first manifestation of what could become a fiscal social contract for the entire energy sector.

A fast track to stateness: Towards a fiscal contract in the energy sector

That a convergence is growing about transparency is unmistakable. Pushed by a number of high profile scandals, the morally reprehensible prospect of the replication of devastating outcomes in the desperately poor and exceptionally violent new exporters of West Africa, and, most recently, the sharp rise in oil prices, Global Witness,[36] the Open Society Institute[37] and (to date) more than 230 other NGOs mounted an international campaign calling for all natural resource companies to disclose their payments to the governments where they operated. The "Publish What You Pay" (PWYP) campaign, launched officially in June 2002, was joined a year later by a broad alliance of governments and most of the major players in the oil industry in the Extractive Industry Transparency Initiative (EITI). Their pledge to voluntarily develop a framework to promote the transparency of payments and revenues started a bandwagon effect. In 2004 alone, the EU parliament passed legislation to promote the publication of payments to governments by extractive companies listed on the European Stock Exchange; the "Publish What You Pay" Act, which called for the utilization of stock market disclosure rules to mandate that American companies make their payments public, was launched in the U.S. House of Representatives; and efforts were started to condition development assistance to oil-exporters on transparency requirements. Even the World Bank and the International Monetary Fund, not especially noted for their own transparency, are examining plans to institutionalize transparency clauses into all of their dealings with oil and mining countries. This transparency campaign has already shown some notable impacts, most especially in Angola where the government and Chevron-Texaco have disclosed some of their oil receipts and efforts have begun to improve public finance (McMillan 2005), but also in Nigeria, Chad, Gabon, Timor-Leste, Sao Tome e Principe, Trinidad- Tobago and Azerbaijan. At least 51 governments are using an EITI template for increasing transparency within their extractive industries -- each pushed from inside by domestic civil society groups linked to the international campaign. [38] BP's more transparent actions in Angola and Azerbaijan are a result of this campaign, and the Extractive Industry Review of the World Bank can also be traced in part to civil society pressure. Despite the growing indications of failure in what were poorly sequenced and very late attempts to improve transparency in the Chad-Cameroon pipeline project, certain innovative mechanisms developed in that project, especially the Oversight Management Plan and the Revenue Oversight Committee, reveal potential designs for institutions in the future.

Building on notions of rights and corporate social responsibility, these halting but initial actions are predicated on the belief that all stakeholders -- the companies, the people in oil-exporting countries, the taxpayers in consuming countries, the governments in consuming countries and the international financial institutions – have an interest in turning the current "lose-lose" situation into a different set of norms: a requirement that transparency about company payments and country resource incomes and expenditures should become standard operating procedures.

But as the logic of the prisoners' dilemma suggests,[39] this is a highly contested process. None of these initiatives have proceeded smoothly,[40] and some have not proceeded at all.[41] The problem is best captured in the debate over mandatory versus voluntary revenue disclosure models, the former favored by NGOs and the latter by international corporations. The companies argue that the sanctity of contracts and traditional notions of national sovereignty make producing countries responsible for taking the first steps to remove confidentiality clauses and other widespread secret practices. They also claim that mandatory agreements would destroy a level playing field since Indian and Chinese competitors and state companies not listed on public stock exchanges would have a significant comparative advantage.[42] PWYP contends that coordination with financial institutions and petro-states themselves would ensure disclosure at the government level, obviating the advantage of a recalcitrant company. Both agree that the consent of host governments for transparency is essential and that this consent can only be won through the combined pressure of financial institutions and the governments of consumer countries. While all stakeholders nominally agree that more transparency would improve country performance, most companies' bottom lines, and the health of the whole energy sector, each is also afraid of moving first and being undercut by others.

Nonetheless, merging agendas, constant interactions and growing widespread popular concerns about global warming and high energy prices are gradually manufacturing the outlines of a new international consensus -- one that is likely to result in a compromise mixing both mandatory and voluntary actions. This is being pushed at two levels: on a country-by- country basis that focuses on aiding domestic groups to create internal pressure inside oil states, and at the level of regional and international organizations that can design

the necessary oversight and compliance mechanisms necessary to underwrite transparency. The weight of expectations is also moving the process forward, creating clear political constraints (rather than legal ones) against business as usual. In the end, however, it is governments, both in producing and consuming countries, who have the duty and the tools to make transparency into enforceable domestic law and (why not?) an international treaty. Certain recommendations flow from this analysis:

- *For all governments*: Both host and home governments should remove all obstacles, legal or political, to the transparent disclosure and monitoring of the oil sector. This would include removing non-disclosure clauses in contracts, guarantees of freedom to publish revenue amounts, and
- *For producing governments*: Oil revenues should be included in the national budget. Furthermore, information regarding revenue as well as expenditure allocations should be distributed widely within the polity through the press, the internet, and a variety of consultative fora.
- *For companies*: Companies should publicly disclose, in a regular and timely manner, all net taxes, fees, royalties and other payments made to producing states, including compensation payments and community development funding. Companies should also pledge to respect internationally recognized environmental and health standards regardless of their enforcement inside oil-exporting countries.
- *For international financial institutions*: Transparency conditionality should be attached to all loans and assistance to oil states and to all Export Credit Agency assistance to energy corporations. Countries and companies that do not abide by these conditions should receive no further assistance and those that engage in "best practices" should be rewarded.
- *For non-governmental organizations*: Both nationally and transnationally, these organizations should strengthen the capacity to collect and disseminate information, develop independent monitoring, and lobby governments, companies and international financial institutions. NGOs should also form "umbrella" coalitions that unite environmental, human rights, indigenous rights, scientific and other constituencies affected by petroleum arrangements.

Conclusion

The resource curse is fundamentally a political problem about the efficient, transparent and just distribution of the costs and benefits from the world's most valuable commodity. As such, it requires a political solution. This will not be easy. While high prices foster a growing constituency in the developed world for reform, they have the opposite effect inside the oil-exporters themselves where reform proceeds furthest and fastest when governments are running out of oil rents. But negotiations in the medium term should be prompted by the desire of all concerned to avoid a worst-case scenario of violence and disorder by accepting a "second best" option. As the oil market moves from conditions of abundant and cheap supply to limited and more expensive energy, the problem of rich states and poor institutions can only heat up -- with terrible consequences only too easy to foretell. And while reform may seem very unlikely to observers who may have become jaded by repeatedly witnessing the tremendous power of oil rents, its seeds are already in place. Transparency is not a stand-alone tool, and it is only a start. But if it is seen as a prerequisite to other types of state and market reforms, it promises real payoffs for managing expectations, reducing social tensions, and providing more stability. In this respect, it has the potential to provide real governance dividends in petro-states, as well in as the international energy sector. Sequence matters in this story. Greater access to information sets the framework for producing better monitoring, and both information and monitoring create incentives for the involvement of those who currently are (but need not be) adversely affected by petroleum exploitation. In a relatively short time, the interactive effects of information, monitoring and participation can create the necessary conditions for making many of the current proposals for overcoming the resource curse begin to work. This is because overcoming information, monitoring and participation deficits can help to create a new consciousness among rulers and citizens that dependence on petrodollars alone is not a sustainable basis for development. This in turn permits a discussion of taxation -- something that is still off the radar screen -- but which eventually will have to play a key role in escaping the all-too-common dynamics of rentier states. Declaring what is being paid to governments, revealing the needs of a country, and showing that plentiful petrodollars are really not so abundant after all will necessarily give rise to debate over how more revenues can be raised. At this point another governance dividend could kick in. Direct taxes not only promote more efficient bureaucracies but also liberal governance and they do so, as Mahon (2005) has shown, *within a very few years of their*

implementation. In this respect, transparency may help to set off processes that represent a fast track to stateness.

More empirical research is imperative for developing the specific reforms that are so badly needed in the energy sector. A number of fundamental questions are evident: To what extent does transparency increase pressures for monitoring, accountability and citizen participation? What conditions are needed for it to operate? Where oil governments are authoritarian and thus view accountability and participation as an anathema, would such governments accept the necessity of building or strengthening merit-based civil service (the other basic requisite for more effective development outcomes), and how are such essential administrative apparatuses effectively created? Are there previous experiences in building more extensive taxation systems in the midst of "plenty" that might provide a learning opportunity for oil governments? What are some identifiable "best practices" within the international energy sector stemming from international oil companies or their host governments that effectively mitigate the risks of extensive environmental damage and human rights violations in regions where oil is found? What type of conflict resolution mechanisms can diffuse tensions in oil regions and begin to build a new basis of trust between companies and citizens? What types of organizational citizen-based action is most effective in mitigating the harmful consequences of dependence on oil? How will the transition from petroleum-based fuel to a bundle of different fuels be managed? And finally, what specific steps can be taken to bring about a new fiscal contract in the energy industry, and in what sequence should they be taken? These and many more questions beg for attention.

However grandiose or out-of reach a 'big push' to curb rent-seeking and other perverse effects of petroleum may seem, half-hearted attempts or partial efforts that single out solely one stakeholder while letting others continue their past practices simply will not work. Nor will technocratically couched reforms that seek to design and control outcomes from the outside in what is sometimes rather euphemistically referred to as 'shared sovereignty' (Krasner 2005). Because partial reforms run the risk of merely moving the huge rents from petroleum from one site to another and creating new grievances in the process, a more comprehensive approach is imperative. A gradually emerging fiscal contract, especially

if mandatory and backed by law, can begin to build accountability, perhaps slowing and even reversing the resource curse with its accompanying slippery slope into violence and war. Anything less is simply rearranging the deck chairs on the Titanic.

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[1] Here, the resource curse refers to the fact that natural resource rich economies have lower growth (Sachs and Warner 1995), worse institutions (Karl 1997) and more conflict than resource poor economies (Collier and Hoeffler 2004). For additional important readings on the resource curse, see note 4.

[2] Note that my argument does not apply to all natural resource dependent countries but only those that live off the exports from a high rent-generating commodity. Despite their widespread utilization of the notion of rents, social scientists have been slow to understand that the 'resource curse' is primarily a rentier phenomenon and thus applies differentially to natural resources depending on the very different extent of the rents they generate. This is why oil-exporters must be treated as a sub-group because the nature of their rents is so qualitatively different.

[3] This is why Wright and Czeslusta's (2004) example of the U.S. as a "successful" oil-producer is misleading. The U.S. was never an oil-exporter that lived primarily from the rents generated by this sector.

[4] There is extensive documentation about these poor outcomes. See, for example, Gelb (1988), Auty (1993, 2001), Sachs and Warner (1995) and Ross (2001b) on economic outcomes, Karl (1997, 1999, 2000, 2004, 2005), Wantchekan (2000), and Ross (2001a) on political economy outcomes, including the relationship to democracy and rule of law, and Le Billon (2001), Collier and Hoeffler (2004,2005) and Kaldor, Karl and Said (forthcoming) on the relationship between oil and war.

[5] On January 31, with crude oil at over $68 per barrel, Exxon Mobil announced the most profitable year for any company in U.S. history, pocketing $36.1 billion in 2005. Later, it was revealed that its CEO's salary amounted to approximately $141,000 *per day*. San Francisco Chronicle, January 31, 2006, E.1.

[6] The Arctic Sea has lost 400,000 square miles of ice in the last 30 years, equivalent to the size of the state of Texas.

[7] The titles of a spate of new books make the point. See, for example, Goodstein's (2004) and Roberts (2005).

[8] For a more thorough explanation of the argument briefly presented here, see Karl (1997), especially chapter 2. For space reasons, none of the numerous other mechanisms affecting state building is mentioned here. Unless otherwise cited, the arguments in this section can be found in my writings listed in the bibliography.

[9] The revenues a state collects, how it collects them, and the uses to which it puts them defines its very nature. More important, variations in the sources of state revenues helps to explain differences in the form states take and the ways in which they relate to their citizens. Nonetheless, the manner in which different types of taxation and public finance shape political institutions has received surprisingly little attention, except in the field of fiscal sociology.

[10] This is defined here as the attempt to design a centralized administrative system to penetrate society and the national territory in order to effect policies.

[11] The manner in which this proceeded reveals important lessons. State institutional development did not progress evenly, uniformly, or in some ideal way. But numerous scholars have noted that where taxes were direct and based on property, e.g., England, they were very visible, and this transparency helped to create

citizens who became monitors of the public purse. Where taxes were indirect and less evident to the populace or where nobles or other powerful interests were exempt from taxation completely, e.g., France and Spain, their cost was less evident and demands for either administrative efficacy, the end of absolutism, or representation were mitigated (Zolberg 1980). Nonetheless, in both cases, states had incentives to develop complex bureaucratic organizations to assess and collect taxes and to train what became a relatively honest and capable civil service.

[12] Historically, even where some tax policy was attempted, there was widespread evasion, especially by the wealthy, the tax base was extremely narrow, policies were not openly debated, and collection was ineffective.

[13] Note that many natural resource rich countries in the developing world are rentier states as are those that rely on significant infusions of foreign aid over time for the bulk of state revenues. Still, oil rents are far higher and of longer duration than those enjoyed by most other rentier states. On rentier states, see, for example, Mahdavy (1970), Beblawi and Luciani (1987), Karl (1997) and Chaudry (1997).

[14] The phrase is from Majon (2005). Under these circumstances, borrowing could not play the same role as a complement to taxation and, in many cases it actually retarded state-building and prevented reform (Karl 1997, Centano 2002).

[15] Tugwell's (1975) description of this bargaining in Venezuela is especially enlightening.

[16] Witness, for example, the well-known case of Mossdegh in 1954 in Iran.

[17] Because individual governments in oil-exporting countries were initially not strong enough to extract good bargains from multinational oil companies, they soon learned to band together, even across continents, to try to build a united front against company threats to move their production elsewhere. Thus, contacts between Venezuela and the Middle East, as early as the 1940s, established accords to jointly demand '50-50' profit sharing agreements and effectively established new rules of the oil game. OPEC would continue these practices after its formation in 1960.

[18] There are key differences among oil-exporters, of course. While Venezuela, for example, has developed these state skills, they are far less present in, say, Kuwait. Although Kuwait has been an exporter for some time, geographic factors, especially the exceptionally easy access to getting its oil from the ground, meant that bargaining over technology never became part of its skill set – a deficit it now has to face.

[19] Amuzegar (1998, 101) claims that subsidies in the Persian Gulf ran as high as 10 to 20 percent of GDP in some years.

[20] One manifestation of the lack of transparency during oil booms is that there is no accurate accounting of the utilization of oil windfalls by the OPEC countries themselves. These figures are estimates by Gelb (1988) and Amuzegar (1998).

[21] I am grateful to Macartan Humphreys for helping with this formulation.

[22] Prices plunged to $12 per barrel in 1998, for example, more than doubled to $30 in 2000, dropped to $20 in 2002, then exceeded $60 in 2005.

[23] OPEC stopped its annual and sometimes semi-annual practice of publishing this data in 1982

[24] The extent to which this is true is difficult to convey. Simmons (2005) notes that this "data vacuum" has led to the proliferation of a whole new class of energy consultants, the so-called "tanker traffic counters," whose job is to estimate production based on observations of tanker traffic at the world's leading loading docks. He recounts the story of Petrologistics, which claims to have spies in all the major ports, though by some accounts has only one employee who conducts his business above a small grocery store in Geneva. Although this employee apparently feeds information to a number of prestigious places, including the all-important IEA Monthly Report, there is no way to verify what is the basis, if any, of the reported numbers.

[25] Reference prices emerge from the interaction between spot markets, more liquid forward markets, and markets which trade. And the most "liquid" markets play the greatest role in oil price determination, but they are also the most removed from physical supply and demand.

[26] When this description was made by an international banker to an OPEC oil minister (in the presence of this author), the oil minister retorted: "Yes, but you bankers were like drunken bartenders!" But borrow they did -- more rapidly and over a longer period than other developing countries (Karl 1997). This permitted leaders of petro-states to avoid badly needed structural changes for longer than other developing countries.

[27] Some countries in the Gulf region, for example, have more foreigners than citizens!

[28] Crude oil and the byproducts of extraction contain significant quantities of toxic substances and other pollutants. These include benzene (a carcinogen), toluene (a liver and kidney toxicant), mercury, lead, sodium (which makes soil unfit for vegetation), hydrogen sulfide (a neuro and reproductive toxicant) and sulfur dioxide (a major contributor to acid rain). Chronic small spills or the improper handling and release of waste and toxic substances can seriously damage local residents, plants, animals and the soil.

[29] This includes higher in-migration, often from other countries, ethnic groups or religions, increased prostitution, AIDS and crime.

[30] This is also the case, for example, of the municipality of Yopal in Columbia, the Bakola/Bayeli pygmies around Kribi, Cameroon and the communities of the Cohan indigenous people in Ecuador. For more on the case of Ecuador, see Gerlach (2003); on Colombia, see Dunning and Wirpsa (2004), on the Sudan, see Human Rights Watch (2003), on Chad/Cameroon, see Gary and Karl (2004).

[31] For a long time, Indonesia was an exception here.

[32] One Venezuelan president was able to secretly buy weapons to channel to Central America; the president of Azerbaijan could tap into the fund to support the conflict with Armenia, and most observers do not know where Kazakhstan's president is spending these revenues.

[33] For example, Norway's state industry is a model company, while many Russian private energy enterprises are very suspect.

[34] Norwegian public policy has led political conflicts over the use of oil revenues, which some voters see as "a growing cake that voters cannot eat". (Listhaug 2005, 834). In an interesting twist, it is the bureaucracy and the permanent government that wants to save. Nonetheless, this is a far cry from the effects of the resource curse, and Norway stands in marked contrast to other oil-exporters.

[35] Note that the Extractive Industry Review of the World Bank Group, which issued its recommendations in January 2004, reached a similar conclusion.

[36] In December 1999, Global Witness published *A Crude Awakening*, exposing the apparent complicity of the oil and banking industries in the plundering of state assets during Angola's 40-year civil war. Because the refusal to release financial information by major multinational oil companies encouraged the mismanagement and embezzlement of oil revenues by Angolan elites, the report called on the oil companies operating in Angola to "publish what you pay."

[37] The other founding members included Oxfam GB, Save the Children UK and Transparency International UK.

[38] Publish What You Pay Newsletter, August 2004.

[39] This occurs when an inability to commit makes all parties worse off relative to the best possible outcome.

[40] The World Bank, for example, launched an exhaustive Extractive Industry Review, which resulted, to the leadership's astonishment, in a recommendation to withdraw gradually from all oil and mining activities -- something it is not prepared to do.

[41] Efforts towards legislation in the U.S. do not have the support of the Bush administration and are stalled in Congress.

[42] Competitiveness with non-Western companies is an especially salient concern of the companies and rightly so. In Sudan, for example, Chinese and Indian companies quickly moved in when the Canadian firm, Talisman Energy, was forced to withdraw due to human rights concerns. In Angola, China won a concession by offering a loan commitment that undercut the IMF's efforts to pressure for improved transparency.