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The Politics of Revenue Sharing in Resource-Dependent States

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Abstract

In a significant number of developing countries, revenue from the sale of a few natural resources accounts for the vast majority of export earnings and a large share of total government revenue. As a result, the allocation of revenue from natural resources is a critical political question. Tensions over the divison of natural resource exports have been repeatedly cited as a central contributor to open conflict in some countries and as the major source of political volatility in many others. In contrast, those countries that manage to develop a fair and equitable mechanism for distributing revenue have the potential to solidify national ties. This study will review the institutional structures that guide the allocation export revenue in developing countries that are heavily dependent on a few natural resource exports.

Keywords: natural resource rents, revenue sharing

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Introduction

In a significant number of developing countries, revenue from the sale of a few natural resources accounts for the vast majority of export earnings and a large share of total government revenue. As a result, the allocation of revenue from natural resources is a critical political question. Indeed, tensions over the divison of natural resource exports have been repeatedly cited as a central contributor to open conflict in some countries and as the major source of political volatility in many others. In contrast, those countries that manage to develop a fair and equitable mechanism for distributing revenue have the potential to solidify national ties.

This study will review the institutional structures that guide the allocation export revenue in developing countries that are heavily dependent on a few natural resource exports. It will examine which countries have formal rules for revenue sharing (for instance, among regions or between the central and sub-national authorities) and those that rely on the discretion of senior leaders. The ultimate purpose will be to understand what types of revenue allocation systems lead to the least political conflict and turmoil. This is a particularly important question because the literature on resource-dependent countries has largely concluded (or assumed) that differential institutional design is irrelevant to how countries use revenue from resource exports.

1 The Assumed Triumph of Sectoral Forces over the State

There is now an extensive and sophisticated literature that studies the political economy of resource-dependent states. That literature largely concludes (or, sometimes, assumes) that the economic and political forces generated by fluctuations in export volume and revenue in natural resource-dependent states are so powerful that they overwhelm any type of political design. For instance, Terry Karl (1997, p. 222), in her important study of oil exporters, notes in her conclusion the "similar political behavior exhibited across historical time, geographic regions, regime types, religions, and cultures regardless of the diverse intentions expressed by policymakers." Further, Karl notes (1997, p. 222) that, "so relentless were these structural pulls [generated by oil exports] that they persistently overwhelmed even the best intentions to 'sow the petroleum' resulting instead in economic deterioration and political decay." Other studies of the political economy of natural resources assign primary importance to the political and economic nature of the sector rather than the design of the state. For instance, Michael Shafer (1994, p. 3) argues that, "[Sectoral attributes] result in distinct patterns of state institutional capabilities, and of interest groups with sectorally determined interests and collective-action capabilities." And Frieden (1991, p. 255) argues that, "Well-organized economic sectors with intense preferences about economic policies (growing from highly specific assets) were expected to have more success in obtaining favorable policies" These authors do not, as Frieden (1991, p. 255) explicitly says, assign much explanatory value to the independent role of the state. As a result, the workings of state institutions regulating export revenue do not receive a significant amount of attention.

Similarly, many of the recommendations from the new literature on economic grievances during civil war focus on changing the resource and sectoral dynamics of developing countries at risk of civil war. For instance, Paul Collier (2000, p. 108) argues that economic diversification and poverty reduction are important in conflict prevention and in post-conflict countries because he finds that conflict often stems from a competition for the few natural resources that are being exploited.[1] He also recommends changing market forces including deregulation, improved transport, and reducing barriers to information flow. However, he does not suggest any reforms to government institutions that might reduce the incentives for conflict. Similarly, de Soysa (2000, p. 126) argues that, "much evidence suggests that countries have far brighter longer-term prospects if they are not dependent on resources, especially mineral wealth." Once again, the potential for state institutions to regulate resource wealth is largely ignored.

The focus on market forces and the relative dearth of attention devoted to political institutions by both economists and political scientists is understandable. First, it is obvious that raw material producers, especially those dependent on one or two minerals, have done exceptionally poorly as a class, irrespective of differential performance between them. The most striking failures have been on the part of oil producers who have received the largest windfalls. The study of the failure of economies to cope with resource dependence has also benefited from the development of economic and political economy models surrounding "Dutch Disease" effects that emphasize inter-sectoral distributions and the dynamics of macroeconomic forces, including the exchange rate. Finally, the new literature on economic agendas during civil wars has also begun to provide some important hypotheses on why resource dependence should lead to conflict.

However, the now almost unquestioned assumption that economic and political forces originating in natural resource sectors will inevitably overwhelm institutional arrangements at least needs to be questioned. It is true that resource dependence does seem to lead in many instances to disappointing economic performance. On the other hand, the relationship between resource dependence and conflict is less well understood. For instance, all of the oil producers may have indeed performed suboptimally but Venezuela, Saudi Arabia, Indonesia, and Iran have had very different levels and patterns of violence. Similarly, general findings about the correlation between resource dependence and conflict say relatively little about different institutional arrangements countries may have attempted. For instance, Bevan, Collier and Gunning (1990, p. 352) find that it was not the increase in government spending fuelled by the Kenyan coffee boom that was necessary the problem but that the government spent the extra funds on services that were not valued by peasants. Bates (1981), in one of the best studies of the politics of revenue allocation from raw material exports, finds that the design of institutions governing different sectors is absolutely critical to a proper understanding of why some groups are more powerful than others.

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1 Indeed, Collier uses share of primary exports in gross domestic product as his proxy for the relative availability of "lootable" resources (2000, p. 93).

Further, if certain institutions would have worked to protect a country from conflict and lead, over time, to decreased dependence on initial resource endowments, these effects would not been detected by cross-sectional economic studies. The decades-long conflict over the rules allocating oil revenue in Nigeria also suggests that many domestic participants believe that the rules of the game are critical to the outcome of political conflicts (see Ashwe: 1986). Even in the highly unlikely event that resource dependence has dominated most institutional arrangements to date, there is still the possibility that countries could develop new institutional arrangements that would ameliorate or eliminate the correlation between resources and conflict.

For countries at risk of conflict the question of proper institutional design is exceptionally important because it may be that changes in the political dynamics surrounding government revenue are more tractable than changing the basic structures of the economy, at least through the medium-term. Diversification of developing countries export portfolios is exceptionally difficult and may be dependent on a host of issues outside the control of any government: overall resource endowment that determine the ability to lesson dependence on any one good, the stock of human capital that might help determine how quickly an economy could respond to new incentives for diversification, and the demands of the international economy at any one time. Of course, changing the institutional structure determining government revenue is hardly easy and is fraught with political obstacles. However, some governments may find institutional reforms still to be easier than wholesale changes in the economy.

2 Obstacles

My initial sample of countries are those that score in the top 25 per cent of the most concentrated economies as determined by UNCTAD's export concentration index (see UNCTAD: 1998, p. 210). This systematic index has the advantage of a global examination of the relative diversification of countries' export portfolios. While, not surprisingly, oil exporters tend to be among those with the most concentrated portfolios, non-oil produces (e.g., Uganda) appear higher than might otherwise be expected and some petroleum exporters (e.g., Venezuela) are lower than many might predict.

Even the least diversified developed country economy (Iceland) has a concentration index (.405) well below the top quartile of the developing countries, suggesting that the paper's focus on developing countries is justified.

Not surprising given the assumptions or conclusions in the literature that institutions are irrelevant to political outcomes, determining the structures and policies that government revenue allocation is exceptionally difficult. I am currently working with the International Bureau of Fiscal Documentation in the Netherlands to gain some systematic overview of how revenue from natural resources in this select group of developing countries is determined. This global overview will undoubtedly have to be supplemented by individual case material on the various countries. It is highly likely that some countries will have to be dropped from the sample simply because it will not be possible to get enough information on the institutions and policies governing their regulation of export revenue. Of course, such selective deletion of cases is hardly desirable because those deleted may share some common characteristics.

Table 1

Top quartile of developing countries by export concentration

Country	Concentration Index	Country	Concentration Index
Kuwait	.94	Bahrain	.629
Angola	.913	UAE	.619
Nigeria	.897	Reunion	.612
Uganda	.816	Mauritania	.61
Iran	.798	Ethiopia	.601
Iraq	.796	St. Lucia	.595
Libya	.782	Belize	.572
Oman	.765	Congo	.557
Saudi Arabia	.743	Nepal	.555
Qatar	.731	Burkina Faso	.555
Gabon	.730	Algeria	.551
Malawi	.68	Tonga	.545
Solomon Islands	.679	Honduras	.535
Seychelles	.677	Syria	.533
Burundi	.676	Venezuela	.521
Rwanda	.664		

A further difficulty is that in many developing countries the rules of the political game are often only honored in the breach. Indeed, the study of institutions in developed countries has proceeded so far (down to the committee level in the study of the American Congress) because it is reasonable to assume that political actors follow the rules. There can be no such immediate assumption in the study of developing countries. To put it charitably, many developing countries have such weak administrative and regulatory capabilities that they may not immediately be able to observe variances in their own systems of revenue collection and allocation. More likely, many individual actors in developing states are able to circumvent institutional designs to enrich themselves and their constituencies. Such institutional circumvention is particularly likely in the allocation of revenue from a concentrated export sector because such monies may represent a large share of the wealth of an individual country. Therefore, during my collection of institutional design and regulatory policy, I am also trying to be sensitive to how well stated policies are enforced. This is an extraordinarily difficult evidentiary question because countries go to great depths to prevent precisely such judgments from being made.

3 Hypotheses

It is only a gentle criticism of the literature on economic agendas during civil wars that the microlinkages between resource dependence and conflict have not been very well specified. Some of the work has only found a correlation between resource dependence and conflict. After the correlations, some well publicized cases (e.g., Sierra Leone and

Angola) are usually cited (correctly) as exemplars of the link between resource dependence and conflict (see, for instance, Keen: 2000, p. 35). Less work has been done on the normal politics of resource dependence in fragile developing countries that have the potential for conflict but have not yet devolved into war or that have resources that are clearly less "lootable" than diamonds. Therefore, examining institutional design is particularly difficult because the literature has yet to state clearly the drivers for conflict.

I suggest that conflict around natural resources is largely determined by two issues. First, how *uncertain* is the distribution of revenue from natural resource exports. In the countries under consideration, how revenue from exports is distributed will be, by construction of the sample, one of, if not the, central political questions. If the relevant political actors are convinced that the allocation of revenue will be determined by a set of rules that they cannot alter, they will have adjusted their political tactics accordingly. Certainty over the course of revenue allocation does not necessarily end conflict because if actors believe that the distribution of money from resources is inherently unfair, they may still be determined to engage in some sort of conflict. However, knowledge that the rules of the game themselves cannot be changed will shape the nature of political conflict. This is precisely why both American presidential candidates have gone to such lengths to stress that the projected surplus will be placed in a "lockbox." They want to convince actors in society that conflict over at least the rules governing social security will not be possible. On the other hand, if actors believe that the immediate monies from export revenues can be reallocated, political conflict will be immediately focused on trying to capture revenues in the short-run.

It is not clear, ex ante, if certainty is always absolutely better for a fragile developing country. Some recent work on Russia (see Treisman: 1999) suggests that the discretion leaders in Moscow had to allocate funds on an ad hoc basis was an important aspect of keeping the Russian federation together as a political unit. However, if such systems of ad hoc allocations continue indefinitely, countries may not go beyond crisis management.

The second set of questions center around how *equitable* the allocation of revenue from exports is. Depending on the country and the relevant political fissures, the most relevant measures of equality will probably be allocation across different regions. One of the major problems with revenue from exports is that the funds usually come from a geographically limited and well-defined area. Allocating money in a way that both the small resource-rich and (inevitably) much larger resource-poor areas find equitable is an extremely difficult problem. Indeed, some countries (notably Nigeria) have gone to great lengths to employ a particular type of fiscal federalism so that different regions feel that they share equally in the country's patrimony. In the case of Nigeria, there has been considerable conflict because different groups in the southeast of the country believe that they have had to suffer from the negative externalities of oil production (notably localized pollution) but have not received enough of the benefits.

In studying how countries allocate funds, I want to pay special attention to reactions to resource windfalls and to sudden collapses in resource earnings. Such moments of opportunity and danger serve to highlight how well institutions and policies regulating export revenue are functioning. The political interests of actors also become clear when everyone understands that business as usual has ended. For example, for oil producers, reactions to the 1990 oil boomlet caused by the Iraqi invasion of Kuwait is a good example of how well institutions function. Everyone understood that the boomlet was temporary and that, especially given the learning that occurred after the oil shocks of the 1970's, there were real dangers in making assumptions that the high prices would continue. Yet, some countries did much better than other countries in resolving disputes over the increased revenue from the oil boom.

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