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Fiscal Policy and the Natural Resources Curse

How to Escape from the Poverty Trap

Paul Mosley

ROUTLEDGE

Fiscal Policy and the Natural Resources Curse

It is widely accepted that natural resource wealth, especially in the form of oil and minerals, can be a key factor in inhibiting economic development. Many of the countries that are richest in natural resources – including oil, metals and diamonds – are among the world's poorest. Why?

Fiscal Policy and the Natural Resources Curse re-examines this ancient, unsolved puzzle, asking why many governments of natural resource-intensive countries are incapable, in a globalised world, of dealing with the natural resource curse. This book offers a detailed analysis of the power-relationships which underpin the natural resource curse, using both statistical analysis and country case studies from Africa and Latin America to pinpoint the strategies that have enabled developing countries to break out of the poverty trap. The book differs from other works on this subject, as it not only identifies the issues at stake but also offers solutions in the form of a series of suggested policy measures. The work focusses in particular on fiscal escape routes, namely measures to develop and diversify the tax system, and to reallocate and target public expenditure.

This volume will be of great interest to scholars of economic development, the economics of natural resources and economic growth as well as all those with an interest in development, global politics and anti-poverty policies.

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For Helena, again and always

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Preface

This book seeks to understand how the politics of poverty and of ‘making poverty history’ works; in that sense, it is a sequel to my book *The Politics of Poverty Reduction* (with B. Chiripanhura, J. Grugel and B. Thirkell-White, Oxford University Press, 2015). However, it is more specialised than that book, because it is concerned with a particular set of developing countries – natural resource-intensive economies, which figure heavily amongst the poorest of all – and also with a particular remedy for poverty, namely fiscal policy, the politics of taxing and spending.

The central idea which we develop in this book is that the prospects for poverty reduction in developing countries depend on bargaining relationships between government and exporters – especially exporters of small-scale export crops. Where those groups have been in a strong bargaining position in relation to government, we find, growth that benefits the poor has resulted (as in Indonesia, Ghana and Uganda), even in the presence of high levels of corruption; but where they have been in a weak position, the economy has been dominated by those with access to mineral rents – in other words any development has been in the interest of the rich and privileged. Thus, the international financial agencies’ current preoccupation with attacking corruption, also known as the ‘governance agenda’, is in many ways misconceived, because if a stand-off, or strategic alliance, between the state and private business interests happens, corruption, on this argument, does relatively little damage to the development of the economy. If the politics can be got right, we argue, the right economics will follow; but what is ‘the right politics’, and in the places where it is wrong, how can it be got right?

In this book, we investigate these questions with reference to a set of natural resource-intensive economies – Indonesia, Chile, Bolivia, Venezuela, Ghana, Nigeria, Botswana and Zambia, whose performance over the last twenty-five years has been very variable: some such as Indonesia and Botswana have gone from severe poverty to stardom over this period, with the help of effective fiscal policy, whereas others such as Zambia and Nigeria have fallen back dramatically. We adopt this focus because natural resource-rich countries are a test case: over the last half-century, they have characteristically been the scene of the worst inequality, the worst poverty and, in many cases, the worst conflicts on the planet, and if matters can be improved in places such as these, there will surely be lessons for other countries too. The politics of building more ‘inclusive states’ has recently been the focus of a research programme on Effective States and Inclusive Development (ESID), financed by the UK Department for International Development (DFID) and managed by the University of Manchester’s Global Development Institute, and I would like to thank Tony Bebbington, the director of ESID’s research programme on ‘Politics and natural resource governance across space and time’, and Sam Hickey and Kunal Sen, the co-directors of ESID, for their support and good advice throughout the programme from 2013 to 2015, and in particular for a research grant which enabled me to do fieldwork in Zambia, Bolivia and Ghana between those years, resulting in Chapters 3–5 of the present book. My fieldwork partners – Marja Hinfelaar in Zambia, Celina Grisi Huber and Denisse Guerra in Bolivia, and Abdul-Gafaru Abdulai in Ghana – not only provided excellent logistical support but also opened my eyes to the politics of those countries to such a degree that they should properly be seen as the co-authors of those case study chapters; others who helped with this fieldwork are named at the beginning of the relevant chapters. At Routledge/Taylor and Francis, Emily Kindleysides and her team were always there with good ideas, and a special mention for Elanor Best who patiently waited past a number of deadlines and was always outstandingly encouraging and supportive.

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Abbreviations

ADN	*Acción Democrática Nacional*, National Democratic Action (Bolivia)
BDP	Botswana Democratic Party
BKK	*Badan Kredit Kecamatan*, microfinance organisation financed by regional development bank of central Java, Indonesia
(C)CT	(Conditional) cash transfers
CMB	Cocoa Marketing Board (Ghana)
COB	*Corporación Obrera de Bolivia*, Bolivian Confederation of Bolivian Trade Unions
CODELCO	*Corporación Nacional del Cobre de Chile*, Chilean National Copper Corporation
COMIBOL	*Corporación Minera de Bolivia*, Mining Corporation of Bolivia, state-owned Bolivian mining enterprise
CONDEPA	*Conciencia de Patria*, Patriotic Conscience (Bolivia)
COPEI	*Comité de Organización Política Electoral Independiente*, Independent Political Electoral Organisation Committee, or Christian Democratic Party (Venezuela)
CPP	Convention People's Party (Ghana)
CSO	Central Statistical Office (Zambia)
DFID	Department for International Development (UK)
DRC	Democratic Republic of the Congo
EPZs	Export processing zones (Mauritius)
ESID	Effective States and Inclusive Development Research Centre, University of Manchester
FENCOMIN	*Federación Nacional de Cooperativas Mineras*, National Federation of Mining Cooperatives (Bolivia)
FISP	Farmer Input Support Programme (Zambia)
FOSIS	*Fondo de Solidaridad e Inversión Social*, Solidarity and Social Investment Fund (Chile)
FSMTB	*Federación de Trabajadores Mineros de Bolivia*, Federation of Mine Workers of Bolivia
GET	Ghana Education Trust
GDP	Gross domestic product

GNP	Gross national product
GRZ	Government of the Republic of Zambia
IAPRI	Indaba Agricultural Policy Research Institute (Zambia)
ICMM	International Commission on Mining and Metals
IDC	Industrial Development Corporation (Zambia, 2014–)
IDH	*Impuesto Directo en los Hidrocarburos,* direct tax on oil and gas revenues (Bolivia)
IDS	Institute of Development Studies (UK)
IFI	international financial institution
IFPRI	International Food Policy Research Institute
IMF	International Monetary Fund
INDECO	Industrial Development Corporation (Zambia, 1965–1988)
INE	*Instituto Nacional de Estadística,* National Institute of Statistics (Bolivia)
IUE	Impuesto sobre las Utilidades de las Empresas, corporate income tax (Bolivia)
KCM	Konkola Copper Mines (Zambia)
KURK	*Kredit Usaha Rakyat Kecil*, microfinance organisation financed by regional development bank of East Java, Indonesia
LDCs	Less developed countries
LEAP	Livelihood Empowerment Against Poverty programme (Ghana)
MAS	*Movimiento al Socialismo,* Movement towards Socialism (Bolivia)
MFEZ	Multi-Facility Export Zones (Zambia)
MIP	*Movimiento Indígena Pachakuti,* Pachakuti Indigenous Movement (Bolivia)
MIR	*Movimiento Izquierdista Revolucionario,* Left-Wing Revolutionary Movement (Bolivia)
MMD	Movement for Multiparty Democracy (Zambia)
MMM	*Mouvement Militant Mauricien,* Mauritian Militant Movement
MNR	*Movimiento Nacional Revolucionario,* National Revolutionary Movement (Bolivia)
NCPE	*Nueva Constitución Política del Estado,* New State Constitution (Bolivia, 2009)
NDC	National Democratic Congress (Ghana, 1992–)
NGO	Non-governmental organisation
NHIS	National Health Insurance Scheme (Ghana)
NLM	National Liberation Movement (Ghana)
NPP	New Patriotic Party (Ghana, 1992–)
PDVSA	*Petróleos de Venezuela S.A.,* Venezuelan state oil monopoly
PERTAMINA	Indonesian government oil and gas monopoly
PF	Patriotic Front (Zambia)
PNDC	Provisional National Defence Council (Ghana, 1981–1992)
PPB-CN	*Plano Progreso para Bolivia – Convergencia Nacional,* Progress Plan for Bolivia – National Convergence (Bolivian political party)

PPE	Pro-poor expenditure
REER	Real effective exchange rate
SAP	Structural adjustment programme (World Bank)
TIPNIS	*Territorio Indigena y Parque Nacional Isiboro-Sécure,* Isiboro-Sécure Indigenous Territory and National Park (Bolivia)
UBLS	University of Botswana, Lesotho and Swaziland
UDAPE	*Unidad de Análisis de Politica Económica,* Unit for the Analysis of Economic Policy (Bolivia)
UNDP	United Nations Development Programme
UNIP	United National Independence Party (Zambia)
UNU-WIDER	United Nations University, World Institute for Development Economics Research
UPND	United Party for National Development (Zambia)
VAT	Value-added tax
YPFB	*Yacimientos Petroliferos Fiscales Bolivianos,* Bolivian State Petroleum Reserves
ZCCM	Zambia Consolidated Copper Mines
ZMK	Zambian kwacha (currency)
ZRA	Zambia Revenue Authority

1 Introduction

We are familiar, now, with the paradoxical idea that natural resource wealth is a major cause of global poverty. Of the twenty-five poorest countries in the world, with a per capita income less than £1,000 ($1,500) in 2014 – including the Democratic Republic of the Congo (DRC), the poorest of all – fifteen are rich in natural resources,[1] in the sense that the extraction of oil or minerals accounts for more than one-fifth of their gross national product (GNP).

But on how to escape from the curse, there is still little consensus. Essentially, the natural resource curse comprises three elements – *economic* (the export surpluses generated by natural resources can make a country's exchange rate uncompetitive, and thus damage its industrial base); *political* (these surpluses often accumulate in the hands of special interest groups with the power to throttle the economy); and *technological* (minerals and oil production are capital-intensive and for this reason generate few additional livelihoods). Each of these explanations has its fierce partisans. Our story in this book, however, will be that all of these problems are interconnected, and all can be defeated by the right fiscal policies.

The economic part of this story originates with the 'Dutch disease' literature of the 1980s, which showed that a boom in mineral production could, by forcing the real exchange rate upwards, damage non-traditional export sectors such as manufacturing. The originating examples were in Europe, such as oil in the UK North Sea and of course Dutch exports of natural gas, but in more recent times the booms in Nigerian oil and Russian oil and minerals, which have had the effect of shrinking their parent manufacturing sectors and in the case of Nigeria their agricultural exports as well, are relevant examples from lower-income economies. This literature has had the merit of putting the spotlight on the real exchange rate as a key determinant of competitiveness, and indirectly on other determinants of competitiveness and development such as infrastructure and export subsidy. It also emphasises (Corden and Neary, 1982: 841) that Dutch disease is not an inevitable outcome of having a booming natural resource sector. The governments of several developing economies with booming natural resource sectors, notably Indonesia, Brazil and China, have aggressively devalued their exchange rates so as to protect their dynamic traded-goods sectors, and the World Bank and others (Pinto, 1987; World Bank, 2003; Rosser, 2004; Sala-i-Martin and Subramaniam, 2003) have shown that the policies adopted by differing administrations during the 1980s and

1990s had very different results on competitiveness and development. One classic exhibit, which we examine below, is the contrasting consequences of an oil and gas export boom in Indonesia – which rose from a low- to a middle-income country during these two decades, and halved poverty – and Nigeria, which did the opposite, and sank during the same period from middle-income to low-income status. These varieties of experience are discussed in Chapter 2, which provides the framework for this book.

Of course, these policy differences were driven by political processes, which are also a crucial element in the story. Indeed, Terry Karl (2007: 256) insists that 'the "resource curse" is primarily a political and not an economic phenomenon'. The essence of her argument is that the possession of natural resource rents weakens institutions, to the point where a rational (economic) allocation of resources by the public sector becomes impossible, and an allocation on the basis of political power takes over. Governments of poor developing countries, on this view, are too weak to stand up to the interest groups who derive rents[2] from mineral production. If this key assumption is accepted, those interest groups are able to force them, in exchange for political support, to adopt policies which will suit their interests, and in effect to run the economy. Typically, these will be policies which keep the exchange rate high and uncompetitive and keep imports cheap (and thereby maximise the income of the rent-seekers), rather than policies to promote and diversify exports, and other policies which will promote development in the long term. In particular, on this view, rent-holders will require governments of less developed countries (LDCs) to keep corporation taxes low or zero as a condition of staying in the country; and this weakens the entire institutional base of the economy, as without a proper revenue base there is no possibility of financing public expenditure for development (Besley and Persson, 2011).[3] And given their weak power-base, the governments of poor developing countries will in any case not dare to raise tax rates for fear of provoking conflict.[4] Therefore, the poorest countries are caught in a vicious circle (Moore, 1999; Brautigam et al., 2008):[5] development requires expenditure, expenditure requires a revenue base, and a revenue base requires a strong state, which in this case is ruled out by the state's dependence on (often foreign) mineral producers. This story certainly gives us an explanation, which takes us further than Dutch disease, of why Nigeria, among many others, succumbed to the natural resource curse in the 1980s and 1990s. But, crucially, it does not provide an explanation of why Indonesia and Brazil did not succumb. And it depends heavily on the assumption that the game between state and mineral corporations is always won by the latter because the state is weak. This is not always true. Indeed, a growing body of empirical studies is accumulating (Poteete, 2009; Hertog, 2010; Booth and Golooba-Mutebi, 2013) which describe cases in which an interventionist state was not captured by, but was able to hold in check, attempts at predation by rent-seekers. We shall draw on these studies extensively in what follows.

The question of why and how some countries resist the anti-developmental pressures of rent-seekers and others do not is clearly fundamental, and has recently been tackled by Douglass North et al. (2007) and by Mushtaq Khan (2010). Both authors see development in all developing and transitional countries as being constrained by the corrupt political influence of special interest groups (rent-holders); but they differ concerning how that influence can be restrained. North portrays the transition from developing-country to advanced economy status (or, in his terminology, from a limited to an open access order) as being a long-period process, sometimes lasting two hundred years and more, and driven by liberalisation, both in the economic sense (removal of barriers to trade and investment) and in the political sense (democratisation), each of which, in his words, sustains the other. As North puts it, 'political competition is necessary to maintain open access in the economy, and economic competition is necessary to maintain open access in the polity' (North et al., 2007: 17). The institutional requirements for moving towards open access, in both the political and the economic sense, are defined by North as (1) rule of law for elites, (2) support for perpetually lived elite organisations, and (3) centralised and consolidated control of violence (North et al., 2007: 21). By contrast, Khan does not see progress from a limited to an open access order as being driven by liberalisation, is more willing than North to see interventionist economic policies as being a way forward, and identifies power-relationships within the elite, and between the elite and excluded groups, as crucial for determining the pattern of economic policy. In particular he sees political settlements in which the ruling coalition is inclusive and no significant factions are excluded from power as being able to exercise restraint on rent-seekers and laying the foundations for a developmental state:[6] 'If excluded coalitions are weak, the ruling coalition is likely to feel secure and act with a longer time horizon. This means that the interests of the ruling coalition are more likely to be aligned with growth and development' (Khan, 2010: 65).

Where a broad-based 'developmental' coalition in which excluded factions are weak coincides with a situation in which lower-level factions (such as organised labour) have little power, the possibility exists, in Mushtaq's view, to achieve fast and equitable growth, as in South Korea and Thailand in the 1960s and 1970s. Mushtaq contrasts this with other Asian outcomes where excluded factions (such as the military governments of Pakistan in the 1960s and Bangladesh in the 1980s and 1990s) or lower-level factions (as in the governments of India under Congress in the 1950s and 1960s) have had the ability to frustrate government developmental initiatives, and uses these examples to show why, in a developing-country context, similar policies, and similar formal institutions, may have widely differing consequences.[7]

A third approach to neutralising the rent-seekers is offered by the Korean-American political scientist David Kang (2002), who shows that in the Far Eastern environment, and specifically South Korea and the Philippines, similar policy frameworks produced very divergent results, with much higher growth and diversification in South Korea in spite of similar policies and similar institutions (including similarly high levels of corruption) in both places. So what was special about South Korea? The magic bullet invoked by Kang is not, like North, rules and competition nor, like Khan, inter-elite competition, but rather an interest group seldom represented explicitly within the elite, namely the business lobby, or more precisely its relations with the state apparatus. Kang argues that during the 1980s and 1990s, the business lobby in South Korea, unlike the Philippines, was strong and cohesive enough to act as an effective countervailing force, or agency of restraint, to a potentially predatory state, and in particular it was able to force the state to implement policies in support of export-oriented business – such as, in particular, a competitive real exchange rate, which was able to propel the South Korean economy towards competition between rent-seekers,[8] and thence sustained high rates of economic growth. There is an obvious family resemblance between this story and Mushtaq Khan's, in that in both cases success depends on an equilibrium in a contest between two groups which have partly opposed and partly common interests (a 'non-cooperative' game); the novelty in the Kang model is that it allocates a key role specifically to the business sector, rather than 'excluded' or 'subordinate' groups, within the game.[9]

The political forces which explain the natural resource trap can therefore be interpreted in several different ways. In Chapter 2, we explore these alternative approaches further, ending up with a variant of the Kang model which is then developed by means of country case studies and statistical tests. Before that, however, we need to bring into our story the third prong in the natural resource curse, much less discussed and documented than the other two – namely the technological dimension. The issue is that mining and, more particularly, oil and gas extraction often generate little benefit for the populations of poor countries, and especially their poorest people, because they are capital-intensive or, otherwise put, take on very little labour – which is a problem because labour is the only thing which the poorest people are able to sell. In one of the great early writings on development strategy, Baldwin (1963) noted that oil and mining industries in developing countries generated few extra jobs – specifically, for every $1,000 of value added, there were:

> 0.033 persons employed in the oil industry and 0.026 for the oil industry in Venezuela and Saudi Arabia; 0.08 for bauxite production in British Guiana [Guyana]; 0.13 for the copper industry of Northern Rhodesia [Zambia] and 0.31 for iron ore production in India.
>
> (Baldwin, 1963: 82, fn. 1)

These low rates of labour absorption in extractive industries contrasted with much higher labour coefficients in agricultural and plantation industries, such as '2.1 in the Cuban sugar-growing industry, 2.6 in the rubber industry of Malaysia, 3.5 for the rubber industry in West Africa and 6.0 in the tea industry of Sri Lanka' (Baldwin 1963: 82, fn. 1).[10] In the common case where an extractive industry is owned by a foreign country, these limitations of low absorption are sometimes aggravated – as emphasised by writers in the underdevelopment-theory tradition such as Frank (1971) and Furtado (1964, 1970) – because not only are few benefits generated for local workers by extractive industries, but much of the capital is repatriated to the country of ownership.[11] Often, these tendencies are linked to the political factors mentioned earlier: for example, as recently shown by Ayee et al. (2011) in Ghana and elsewhere, decisions concerning technology, both in the mines themselves and in backward linkage industries which supply inputs to the mining industry, are often made by staff of foreign mining corporations responding not to local financial and political imperatives but to those of overseas countries, using the standard technologies their company has always used worldwide rather than the ones which would best fit local factor endowments. This, even in the twenty-first century, gives an enclave character to large-scale mining (Ayee et al., 2011: 45): the host developing economy is inhabited by capitalists from other continents who operate their mine, or oilfield, simply as an outpost of the investor's economy, having no other connection with the host country. This kind of 'dual economy' is found especially in environments such as Zambia, Chile, Ecuador and Botswana, where no significant small-scale, locally owned extractive sector exists. In cases such as Bolivia and Ghana which have substantial small-scale mining sectors, there is much more scope for flexibility of both technology and policies, and we explore these possibilities in Chapters 3 and 5.

Natural resource industries, therefore, generate a great deal of profit per capita but very little labour income; otherwise put, they add to local inequalities in the distribution of income and wealth, which causes natural resource states to be often fragile and politically unstable. Thus, for those who have not managed to construct adequate defences against this source of vulnerability, technical rigidity adds an extra twist to the poverty spiral; it also constrains the labour market, and makes more important the use of other levers, such as the fiscal policies discussed in this book, as a means of reducing poverty.

We have already discussed several ways of escaping from the natural resource poverty trap, and we shall encounter others in the course of this book. The focus here is on *fiscal escape routes* out of the trap – measures to develop and diversify the tax system, and to reallocate and target public expenditure – and the political motivations and alliances (coalitions) which enable those escape routes to be taken. Fiscal escape routes are particularly relevant in mineral-intensive countries because such countries, as described above, tend to be capital-intensive, rendering labour markets, the classic anti-poverty instrument, relatively weak in these cases. Across a number of developing countries, we explore what agencies of restraint and what types of alliances are capable of combating the state weakness and vulnerability to conflict which lie at the heart of the natural resource curse, and are major causes of poverty and inequality globally. In particular, we highlight a number of exciting innovations which have sprung up in recent years in the field of 'linked export taxation' – new taxes linked to pro-poor public expenditure measures – and illustrate how they have been able, in some cases, to help such alliances to form. Comparing across a number of developing countries, especially in Africa and Latin America, we analyse the conditions under which such coalitions have formed, come under stress and in some cases broken apart, and relate these political events to trends in poverty, such as countries' ability to meet the Millennium Development Goals. Chapter 2 sets out the basic analytical framework, and provides vignettes both of a set of developing countries which have succumbed to the natural resource curse and of countries which have overcome it, attempting in the process to illustrate how wide is the variety not only of reasons why things can go wrong, but also of possible escape routes. This chapter is followed by case studies of three natural resource-rich developing countries with varying economic structures, political institutions and policies: Ghana, Zambia and Bolivia (Chapters 3–5). These test out the analytical framework of Chapter 2 against local data, which in turn requires the basic explanatory story to be modified. This modified story is then, in Chapter 6, tested out on a larger sample of developing countries, using both qualitative and quantitative (econometric) evidence. The concluding Chapter 7 examines, in the light of this evidence, what policies and institutional reforms offer the best prospects for creating 'developmental states', combining equity and dynamism, within the often challenging environment of natural resource-intensive countries, and presents our policy ideas and recommendations.

Notes

1 Data from World Bank, *World Development Report 2014*, appendix, table 1. In ascending order of per capita income these sixteen countries are: DRC (per capita income $220), Niger ($370), Guinea ($460), Uganda ($440), Central African Republic ($490), Tanzania ($570), Sierra Leone ($580) Southern Sudan ($650), Zimbabwe ($680), Chad ($740), Tadzhikistan ($860), Mauritania ($1,110), Yemen ($1,110), Zambia ($1,350), Nigeria ($1,430).

2 *Rents* is the term applied to any income derived from any resource which is in fixed or limited supply, such as land or non-renewable natural resources such as oil. They became important in international policy debates in the 1970s as it came to be realised that resources could be made artificially scarce by policies such as import licensing – creating a new class of 'rent-seekers' who derived benefit from exercising pressure on governments to restrict access to key inputs, and who therefore had an interest in protection rather than free trade (Krueger, 1974). In the poorest resource-rich states, such as the Republic of Congo and Equatorial Guinea, resource rents were estimated to be over 80% of gross national income in 2006 (Arezki and Gylfason, 2013: 553).

3 'Countries that have better fiscal capacity also trend to have better legal capacity. Both measures are also correlated with contemporaneous GDP per capita' (Besley and Persson, 2011: 7; see also ibid., pp. 31–33, 40–102, 131–138). The case for the primacy of taxation as a development instrument has also been made by Deborah Brautigam: 'Taxation is an underrated tool in the effort to build more capable and responsive states. . . . Democracies are built not only on periodic elections but also on a social contract based on bargaining over the collection and spending of public revenue. [Indeed, we can argue] that taxation may play the *central* role in building and sustaining the power of states' (Brautigam, 2008; see also Brautigam et al., 2008: 1–2; italics in original).

4 Another fiscal factor which weakens natural resource-based states is the volatility of their resource inflows – often aggravated by the development of unsustainable patterns of consumption during the boom, leading to insufficient saving (hence lower rates of growth) and failure to adapt to lower levels of expenditure during the downswing (hence debt management problems; Gelb, 1988).

5 Many economists, as well as political scientists, accept this second story: for instance, Collier (2007: 42) argues that 'without discounting the older economic explanations, . . . the evidence points to governance as the key problem – although even in the poorest countries (in particular in Africa), things are changing in a democratic direction. Indeed, Collier additionally argues that democracy is part of the problem, not

part of the solution, and that ‘ the heart of the natural resource curse is that rents make democracy malfunction’ (ibid.).

6 A particularly relevant case of this in Africa is Botswana; see Poteete (2009), further discussed on pp. 24–27 below.

7 Khan (2010): 77–139, summarised in ibid., fig. 17, p. 65.

8 Anne Krueger’s paper ‘The political economy of the rent-seeking society’ (Krueger, 1974) seeks to measure rents deriving from import licensing (in India and Turkey) and valuably draws attention to the possibility of competition between rent-seekers, but stops short of trying to measure the impact of degree of competition on productivity, which is the direction in which Kang’s analysis leads us – see further Chapters 6 and 7 below.

9 Of course, a reconciliation between this and Khan’s approach can be achieved by treating the business sector as a group which may be included or excluded by the ruling coalition: see Khan’s discussion of Thailand in Khan (2010: 79–89).

10 These data of Baldwin’s relate basically to the 1950s. However, his proposition that natural resource industries operated by multinational enterprise are inherently capital-intensive continues to hold good in the twenty-first century. In Bolivia, for example, the state oil and gas monopoly YPFB, with value added of $3.87 billion, in 2011 employed only 37,000 people, which is 0.01 people per $1,000 of output (by comparison with 0.21 people per $1,000 of output for the economy as a whole); see Table 5.4 below.

11 Neo-classical economics, of course, would insist that such findings are unbelievable, because production technology is dictated by local factor endowments, and in most places in the developing world labour is in abundant, even unlimited, supply. But in the real world, this surplus labour is perfectly compatible with high capital-intensity – partly because of local tax and subsidy policies, discussed further below, partly because multinational corporations operate with standard technologies across different environments, but much more than either of these because of limitations on technical flexibility: the technologies which ought to exist at the labour-intensive end of the spectrum simply are not there. This is especially true in environments such as Zambia and Botswana, where no significant small-scale mining industry exists. Non-governmental organisations (NGOs) such as the Intermediate Technology Development Group have fastened on to this problem and created many of the labour-intensive technologies which are required, but this is mostly in small-scale industry and in activities such as agriculture, textile production and construction; much less in mining and less still in oil and gas production.

2 The way forward

How do ‘inclusive’ alliances happen?

2.1 Analytic framework

As we have seen, having an extractive industry base does not condemn all developing countries to a poverty trap. Some countries escape. But how do they escape? We have presented three alternative answers: by enforcing rule of law, liberalisation and centralised control of violence (North), by creating inclusive political coalitions (Khan), and by reaping the dividend from a ‘strategic alliance’ between business and the state (Kang). All these studies are mainly deductive, and use rather little statistical analysis: there is no reason to prefer any one of them to the others on empirical grounds. Therefore, what we shall do is to start with a basic version of the story which best seems to explain the key issue of what kind of politics achieves global competitiveness (the Kang model), and then adapt that model so that it takes in key features of the Khan and North models also, and also encompasses the broad objective of reducing poverty rather than the narrower objective of promoting growth. In the process of doing this we shall bring in thumbnail illustrations of eight countries which have had varying success in tackling the natural resource curse. This will enable us to develop the model further towards a testable hypothesis; the story is eventually tested in Chapters 6 and 7. The first two of these eight countries we have already encountered as examples of how to manage and how not to manage the resource curse respectively: Indonesia and Nigeria. The other six fit along a spectrum: Chile, Botswana and Ghana clearly provide inspiration for those seeking escape from the curse; Venezuela and Zambia equally clearly illustrate the dangers which lie in wait for undefended governments; and Bolivia is an interesting intermediate case, having spent most of its two centuries of independence under the domination of foreign mining companies but currently witness to a fascinating attempt to escape from the poverty trap. Three of these cases, Zambia, Ghana and Bolivia, are then developed in more detail in the case studies of Chapters 3–5.

The Kang model arises out of a question which has worried students of development for a long time: why, if corruption is fairly universal in developing countries, are some of those developing countries, although beset by corruption, able to grow quickly and others not? The question is obviously linked to the question raised in Chapter 1 – what kind of bargaining power does government have in relation to business, and what kinds of counter-strategies do governments possess, in the interests of development, to defend themselves against being stripped of their power to control economic policy?

Kang's analysis compares South Korea and the Philippines – two East Asian countries which historically have both had high levels of corruption. The difference between the two is that in South Korea growth rates appear not to have been harmed by this corruption – indeed, for the past fifty years no other country has grown so fast – whereas in the Philippines corruption does seem to have caused harm, in the sense that growth has been lower, more unstable and more socially divisive. Kang's book explains these differences in terms of the structure of state–business relations, as portrayed in Figure 2.1. In that diagram, the state is characterised as being either politically unified (*coherent*), as in South Korea, or divided between different factions (*fractured*), as in the Philippines, and the business environment is represented as either *concentrated* (a situation which materialises more easily if businesses are clustered in large conglomerates, as with the *chaebol* (South Korean business conglomerates, such as Samsung and Hyundai) or *dispersed* between multiple interest groups. The outcome then turns on the balance of power between business and the state and its stability. If the state (the dominant coalition) is coherent and private business dispersed, the outcome of the political settlement is *predatory* (domination of policy, and capture of economic surplus, by the state and its parastatals), as in the bottom left-hand cell of the figure; this is the state of affairs which, according to Kang, prevailed under President Marcos in the 1970s, with the lion's share of rents appropriated by the president and his extended family. The reverse is the case if the state is fractured and private business concentrated, with the state a captive of specific groups of rent-seekers: in this case the predator becomes the prey and groups of rentiers (commonly, in Africa, importers and interests linked to them) dominate the allocation of surplus, as in the top-right cell of the diagram; this is essentially the image of all mineral economies presented by Karl's 2007 chapter, as summarised above. In both these off-diagonal cases, any possibility of an 'efficient' outcome, in which the forces of competition continuously drive up productivity, is overwhelmed by the power held by private or public rentiers, and the result is policies which blunt competitiveness, such as overvalued exchange rates, price controls and exchange controls, and blanket trade protection. However, if the state is coherent and business concentrated, as in Kang's interpretation of South Korea, there is a stand-off or, as Ayo calls it, a 'strategic alliance': each of the two duopolists neutralises the other, because they need each other. The state needs business to propel and sustain the economy, and business needs financial support from the state, both short-term at times of crisis and longer-term in the form of tax concessions, and, acknowledging their mutual dependence, both parties may settle for a compromise allocation of mineral rents and other surpluses generated by the economy rather than each attempting to checkmate the other, on the grounds that they have more to gain by acknowledging their dependence and colluding than by fighting to the death. This has been described by Kang as a 'mutual hostages' outcome (Kang, 2002: ch. 4).[1] In this case, the persistence of corruption and patronage is consistent with, and may even give an incentive to, policy determined by the requirements of global competitiveness, because the number of actors who have to be paid off is quite small and because the state knows that it can divide and rule, playing off its clients against one another and penalising them if they demand too much.[2] In Kang's words:

> if there is a balance of power among a small and stable set of government and business elites, money politics can actually reduce transaction costs and make long-term agreements and investments more efficient, even while enriching those fortunate few who collude together.
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> (Kang, 2002: 3)

This framework is, we believe, a promising way forward. However, in order to convert it into a set of ideas which can be tested – often in relation to economies which are much poorer and more fragile than either the Philippines or South Korea – and in order to relate it to the theme of escape from poverty, we need to make several modifications.

First, we need to disaggregate the actor called 'business', as the motives of different kinds of businesses are very different. Specifically, the motives of and therefore the policies supported by importers are very different from the policies favoured by exporters – importers need a high real exchange rate which depreciates as slowly as possible in order to secure their inputs as cheaply as possible (and their clients need this to get cheap food, cheap gasoline and so on) whereas exporters need a competitive, therefore a flexible and rapidly depreciating, exchange rate in order to maximise and diversify exports.[3] The analysis of this chapter, therefore, will focus on the political role of exporting businesses, and the relationship of these businesses to the state, rather than on 'business' as a whole.

Second, we also need to disaggregate the actor called 'politics', which Kang represents essentially in terms of the bureaucracy (especially the president's office,

		STATE	
		Coherent	**Fractured**
BUSINESSES	**Concentrated**	*Strategic alliance* Export-competitive businesses and state counterbalance one another: hence rentiers do not obstruct international competitiveness	*Rent-seekers indulged* Rentier-importers provide political support to state, in return for economic favours
	Dispersed	*Predatory relationship ('vampire state')* Rentiers extract economic favours (notably tax exemptions) from the state	*'Residual category'* Free competition (*laissez-faire*)

Figure 2.1 Competitiveness as determined by state–business relations (after Kang, 2002)