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Blame it on Nature

Doctrine of the Resource Curse

BLAMING OTHERS is a ploy that has been with us from the beginning of psychological time.

The Reverend Thomas Malthus diverted responsibility away from the architects of poverty in 19th century Britain, blaming the victims for their plight. To his way of thinking people on low incomes are responsible for failing to control their sexual appetites. They reproduce beyond their ability to clothe and feed their children.

For many people, hardship in a world with a billion people subsisting on less than $1-a-day needs to be explained in terms that are reassuring. But if we do not wish to blame the poor, a metaphysical explanation needs to be conjured up. Nature has now been elected as the proximate culprit. Starving children, their shocking images portrayed on TV news programmes, are the victims of a "curse".

The thesis that nature is to blame has been endorsed by Jeffrey Sachs. His thesis was taken up by billionaire philanthropist George Soros and others, and received scholarly analysis by Paul Collier at Oxford, where he directs the Centre for the Study of African Economies.

Sachs and his collaborators showed that countries rich in natural resources tended to grow more slowly than those that were resource poor. This was the curse that nature apparently inflicted on populations that were unlucky enough to occupy territories endowed with oil, diamonds and gold.[1] Sachs explored the "roots of failure in natural resource-led development", and the curse turned out to be the villain.

Sophisticated statistical analysis led him to the conclusion that "empirical support for the curse of natural resources is not bullet proof, but it is quite strong".[2] We shall show that blaming nature's munificence is a travesty.

- Land-rich Costa Rica did not suffer from a resource curse in the 18th century.[3]
- Gold-rich Australia did not suffer from a resource curse in the 19th century (see pages 143–149).
- Diamond-rich Botswana did not suffer from a resource curse in the 20th century (see pages 49–58).

These, and other cases, demonstrate that to talk in terms of a "curse" merely distracts politicians who are looking for an excuse to avoid their obligations. Sachs missed something. In the cases that we cite, the populations that harnessed their natural resources for the common good adopted tenure-and-tax policies that facilitated economic growth. The economic rents were not allowed to distort society and retard growth; in fact, they were harnessed to fund growth.

Paul Collier investigated the so-called resource curse after moving to Oxford from the World Bank, where he served as Director of Development Research. The sincerity with which he addresses the plight of the billion people on the lowest incomes is not doubted. And he does not pull his punches in his account of what needs to be done to help them out of the poverty trap. But an escape plan that fails to identify the starting point is liable to lead down a *cul-de-sac.*

Poverty is at its deepest in the 50 states around the world where, despite strenuous efforts by international aid agencies, the route out of poverty is strewn with seemingly insurmountable traps. Who is to blame for the corruption and civil conflicts that blight people's lives? What Collier describes as "paradoxical" is "the discovery of valuable natural resources in the context of poverty".[4]

> The heart of the resource curse is that resource rents make democracy malfunction.

According to Collier, rents – such as those from oil – "have substantially reduced the likelihood that a society is democratic". So damaging were the riches of nature that the professor concluded that "*without* natural resource surpluses, democracies outgrow autocracies" (emphasis added). To drive home the implicit thesis that poverty-stricken populations in Africa would be better off without the flow of rents, he declared that

> In the absence of natural resource surpluses a fully democratic polity outperforms a despotic autocracy by around 2% per year. By the time natural resource rents are around 8% of national income, the growth advantage of democracy has been eliminated. Beyond this the net effect of democracy is adverse. Taking a country with resource rents worth 20% of national income, the switch from

autocracy to intense electoral competition would lower the growth rate by nearly 3%.

There is apparently much to curse about nature's generosity in providing resource rents! Here is an explanation for poverty and civil strife that relieves the human race of guilt. The doctrine of the resource curse is treated as a serious scholastic theory, and Professor Collier devoted serious research time to exploring the problem. With co-worker Anke Hoeffler, he estimated the rents generated by natural resources, country by country and year by year. He correctly defined rents as the excess of revenues after deducting the costs of production. This was a careful exercise, because the size of the economic surplus varies for a long list of reasons. He explains:

> Estimating the rents on primary commodities is an important advance on just counting their value: the rent on $1m of oil exports is much greater than the rent on $1m of coffee exports because the costs of production are much lower. So data on primary commodity exports, which is what people had used when they had bothered to look at the numbers, are a poor guide to how valuable the resources really are. And even $1m of oil exports generates a bigger surplus if it is coming from an easy-to-exploit onshore location than if it is deep offshore, and if the price per barrel is $60 rather than $10.[5]

Collier and Hoeffler compared the flow of rents with political institutions and drew the conclusion that rents "both undermine governance, and are dysfunctional in the context of poor governance". Thus, by this logic, resource rents undermine the checks and balances in democracy (such as press freedom) "and thereby facilitate patronage politics, reducing public goods provision in the process". When the rent tap is turned on, altruism is subordinated to embezzlement for private gain. Ill-informed voters are manipulated by their leaders in the quest for the power that gives privileged access to the easy life funded by rents.

Collier and Hoeffler decided that it was easier for the public to control their leaders when they had to pay taxes, because this encouraged people to scrutinise what was done in their name. But resource rents, apparently, do not inspire citizen scrutiny. It gets worse for those countries that are well-endowed by nature. For as rents increase, government can lower the revenue received from taxes on people's wages and savings. This consequently reduces the level of public scrutiny of politicians, "and so the rate of embezzlement is higher".

This is, indeed, a bleak scenario. One would think that the riches of nature would help to banish poverty. Not so, it seems, based on the way scholars like Collier analyse the role of rent. It appears that governments welcome the opportunity to raise revenue from resource rents instead of by taxing people because this enables them to escape public scrutiny. As a result, those governments are under less pressure to provide public services. Depressingly, Collier and Hoeffler conclude that "comparing two societies with the same level of income but with different shares of natural resource rents, the one with the higher share will have the worse provision of public goods".

From this, it would appear that the rich West has been doing the poor nations a favour by relieving them of their resource rents and of urging them to raise tax revenue from labour and capital instead. After all, as Collier and Hoeffler note, "democracy enhances growth except in the presence of substantial natural resources where they retard it". To stress the point, they explain that "in the absence of resource rents democracy is good for growth".

And as it happens, that is what the policies prescribed by agencies like the World Bank and the IMF have achieved. The doctrine that relieved the neo-colonial countries of resource rents is known as The Washington Consensus.

Colonialism by Other Means

WHEN FORMAL colonialism came to an end, European powers retreated without unscrambling the institutions that they had bequeathed. The jurisdiction of the imperial powers was withdrawn, but the expectation continued that they would enjoy privileged access to the resources that attracted them to the distant lands in the first place. Preferential treatment was secured to exploit the benefits that flowed from the preservation of the granite pillars of the West's social architecture, the property laws and the related financial institutions which remained embedded in the soils of the former colonies.

Could this be the reason why so many countries remained locked in poverty? A mathematically rigorous approach to examining this question was employed by Daron Acemoglu and his associates at the Massachusetts Institute of Technology and the University of California (Berkeley).

Acemoglu, a professor of economics, went in search of what he, too, called *root causes*. Using algebra and the best data available, he concluded that the colonial project was one designed to enrich the European colonists. The settlers chose those institutions that best served their interests. Where they were not able or willing to settle in other people's territories, "they introduced or maintained existing extractive institutions when it was in their interest to extract resources from the non-European populations of the colonies, as in much of Africa, central America, the Caribbean, and South Asia".[6] The common theme that runs through the prolific work of Acemoglu and his colleagues is the role of rent in the fate of nations, both during and after colonialism.

> In almost all cases, we can link the persistence of extractive institutions to the fact that, even after independence, the elites in these societies had a lot to lose from institutional reform. Their political power and claim to economic rents rested on the existing extractive institutions...[7]

Territories that were rich before the arrival of Europeans suffered a reversal of fortune, and ended up being impoverished. They were the victims of the extractive process by which the colonists leeched the economic rents out of the country. In contrast, a different strategy was employed in those territories that were sparsely populated and where disease was not a threat to Europeans. Here, the settlers replicated the institutions that favoured economic growth. Acemoglu discovered that variables such as geography (for example, locations in the tropics) did not account for the different institutional strategies that were employed by Europeans.

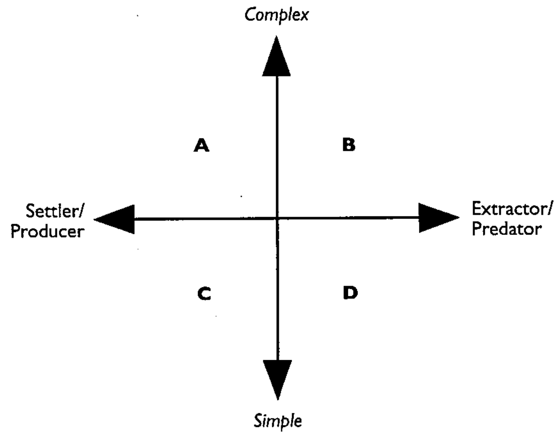
Others – such as Jeffrey Sachs – claimed that poverty could be explained, in part, by the proximity of a country to the equator. Acemoglu *et al* demonstrate that, once they factored institutions into the equation, "countries in Africa or those closer to the equator do *not* have lower incomes".[8] Similarly, the Sachs thesis that diseases such as malaria affect economic development was also incorrect. People who lived in high malaria-prone areas developed immunity, so the disease would have little direct effect on the economic performance of the indigenous populations.[9]

Advocates of foreign aid (like Sachs) were missing something crucial. Acemoglu *et al*, in searching for the fundamental causes of the large differences in income *per capita* between countries, spotlighted the role of institutions. In particular, they subjected property rights to forensic interrogation. Popular hypotheses on the causes of poverty were rejected in favour of the role of private property. This, apparently, was the key factor that encouraged investment and economic growth while diminishing corruption and civil conflict. Their analysis is convincing, but they admitted that many questions were left unanswered. In particular, their "institutions are treated largely as a 'black box'".[10] That mysterious box, which serves to conceal the true nature of the institutions they are dealing with, needs to be levered open.

We believe that Acemoglu *et al.* failed to identify the root causes of poverty because their model of institutions is too simplistic. They employ a concept of property rights that fails to reflect the rich texture of the institutions that were adopted by European settlers in foreign lands. As we shall see in chapter 6, significant differences in strategies were employed.

A more complex analytical framework is needed, which we have stylised in the figure opposite. On the horizontal axis we locate the institutions that favour (at one extreme) the predatory tactics of the colonists dedicated to extracting resource rents – such as absentee gold mine owners – in contrast to, for example, Europeans who settled and invested in the local economy. On the vertical scale we

Property Rights



locate property rights. Anthropologically speaking, people have traditionally recognised that property falls into two categories: those rights that are personal, and those rights that inhere in the community. How else could a community function, if it did not have a claim on output? The traditional allocation was based on the difference between property rights that delivered incomes that were earned, as opposed to those that were designated as unearned. The policies that flow naturally from this distinction are elaborated in Part 3. At one extreme of our figure's scale are the simple private rights to which Acemoglu draws attention. At the other end of the scale are the complex rights which disaggregate the benefits that flow from property.

A sophisticated theory of property rights and economic activity offers a deeper explanation of the root causes of that poverty which is pre-determined by institutional arrangements. With our framework, we can fill in the pieces that are hidden in Acemoglu's 'black box'. Thus, we would place

19th century Australia (see p. 143) in the A quadrant of the figure, while 19th century Argentina's institutions (see p. 140) would locate it in the C quadrant. We understand that the manner in which the resource rents were distributed shaped the fate of indigenous populations and the new settlers. So we can account for the persistence of poverty today.

Unfortunately, however, absence of agreement among social scientists about the fundamental issues means that, after 250 years of scientific economic reasoning, there is little consensus on what delivers prosperity. Sachs, for example, admits that economists could not agree about what drove economic growth, and "we have a similar diversity of views on the natural resource question. In other words, a complete answer to what is behind the curse of natural resources therefore awaits a better answer to the question about what ultimately drives growth".[11]

In our view, the decomposition of economics into fragmented schools of thought is the logical consequence of the refusal to integrate into theory the *spatial* context of life, represented, in economics, by the concepts of land and rent. This spatial dimension, however, is obscured because economists insist on treating them as 'capital' and 'profits'. Consequently, given present-day thinking, it is unlikely that even mighty global agencies such as the UN will formulate a coherent strategy capable (in principle) of delivering prosperity and peace on a sustained basis.

Our hypothesis is that people have the power to create that prosperity for themselves. So our challenge is: what is stopping them?

People-Power Rents: A Sub-Saharan Paradigm

AFRICA'S BLEAK history of neo-colonialism is legend, but the clues to prosperity can be excavated from that past with the aid of the right tools.

Botswana, for example, has performed remarkably well compared to her sub-Saharan neighbours. Why? The country's *per capita* income of nearly $10,000 far exceeds what others are achieving (see table below). There is even better news, however. Botswana is free of civil conflicts. She has enjoyed democracy for the last 40 years. Contrary to the Sachs resource curse thesis, and the Collier democracy thesis, this country effected a successful transition to post-colonial sovereignty.

Five Sub-Saharan African Countries: selected indices (2006)					
	Botswana	*Namibia*	*Uganda*	*Zambia*	*Malawi*
Income per capita (US$)	9,945	7,418	1,478	943	646
Top income tax rate (%)	25	35	30	37.5	40
Top corporate tax rate (%)	25	35	30	35	30
Tax revenue (% of GDP)	36.9	27.3	11.7	17.6	20.1
Population (millions)	1.8	2	27.8	11.5	12.6
Unemployment (%)	23.8	34	n/a	50	n/a

Source: Kane, Holmes and O'Grady (2007)

Botswana is rich in diamonds, gold, nickel and copper, yet she does not suffer from the resource curse. She is also landlocked, which according to Sachs is supposed to be a constraint on economic growth. This is a country with relatively low tax rates, high public spending on school and health services and it is ranked as Africa's least corrupt country, with one of the world's highest average growth rates over the past four decades. Here is a puzzle that needs explaining. Can we open Acemoglu's 'black box' to discover why Botswana is a model for her neighbours?

The IMF posed the question: *Did Botswana escape from the resource curse*? "Resource rents tend to bring about not only conflict but also corruption."[12] Botswana, however, dedicated her resource rents to investment in public infrastructure under a fiscal discipline called the Sustainable Budget Index. In addition, government channels rents into the Pula Fund, which invests for the long-term benefit of the nation. But *why* does Botswana's government behave in this public-spirited way instead of dissipating rents in corruption and conflict? This was the question addressed by Daron Acemoglu and his colleagues. They conclude that Botswana had good institutions, which they define as *institutions of private property*.[13] They stress the importance of the individual.

> How did these various features of Botswana's history and political situation affect the design of its institutions? To answer this question, we first have to note that institutions are ultimately the endogenous creation of individuals. Institution building, therefore, has to be analysed within the context of the interests of the actors and the constraints facing them. [14]

We shall explain in chapter 3 that this stress on the role of the individual is a serious misrepresentation of reality. It understates the role of institutions and culture in general, in enabling people to make decisions that are of mutual benefit to everyone in the community. The primary example is the provision of what economists call 'public goods' – the shared services (public health, transportation) that we need as we go about our daily lives.

The key, in this case, was noted by Acemoglu and his colleagues: the colonising British did not unravel traditional tribal practices. But nor did they invest in the territory's infrastructure. So when colonial rule ended in 1966, the country was much as it was before the intrusion of Europeans. The outcome was the survival of tribal institutions that encouraged broad participation in decision-making and traditional constraints on tribal leaders. But what, precisely, disciplined the people and their leaders to ensure good economic policies when, "in the rest of Africa, good economics is often bad politics – ie, good economic policies often do not generate enough rents for politicians, or they make it more likely that the government will be overthrown".[15] Acemoglu *et al* employ mathematics to compare the institutions of a variety of countries to conclude that *effective property rights* which are associated with *institutions of private property* (their emphasis), provide the answer: success in Botswana was not due to the rich resource endowment but good institutions.

Those institutions reach back to pre-colonial times, when "land was collectively owned [and] cattle were privately owned".[16] Following independence the government passed the Mines and Minerals Act (1967). This vested sub-soil mineral rights in the national government, at a time when the country had one abattoir, two secondary schools and few paved roads. Then diamonds were discovered, followed by copper and nickel. The spectacular record of social development was the consequence, because "these resource rents have been invested rather than squandered".[17]

> Diamond rents were widely distributed and the extent of this wealth increased the opportunity cost of undermining the good institutional path – no group wanted to fight to expand its rents at the expense of 'rocking the boat'.[18]

But to what do we attribute the cultural ethos which facilitated the diffusion of rents, through government, in a way that raised investment in infrastructure? Acemoglu *et al* insist that this was the result of "an underlying set of institutions – institutions of private property – that encouraged investment and economic development".[19] Our competing thesis is that *it was the traditional ethic of sharing land – of collective property rights in the resources of nature (land), but not of capital (cattle) – that explains Botswana's remarkable achievement.*

In 1980, a survey of property rights in land was presented by a politician who was to become Deputy Speaker of the Botswana legislature. BK Temane described three distinct land tenure systems. Freehold land represented 6% of the total. State land covered 23% of the territory, and 71% was designated as tribal land.

> Historically, all land in Botswana was vested in the Chiefs of various tribes to be held in trust for members of that tribe. Land was allocated by the Chiefs' representatives – the ward head and sub-ward heads upon application by tribesmen. Membership in a given tribe ensured an individual's right of access to tribal land for his use.[20]

After independence, tribal arrangements were preserved through the Tribal Land Act (1968). Modifications, such as the Tribal Grazing Policy, were undertaken only after extensive consultations through the *kgotla* (village) meetings, so people were able to influence legislation. Land boards were created and land allocated on the basis of leases of 50 years (renewable). "The leaseholder is also subject to a rent on the land payable to the land board, subject to review every five years," reported Temane.[21]

In the tribal land tenure system, "speculation in land is avoided and even the poorest member of the tribe is not 'landless'".[22] Freehold tenure in towns was regarded as a "relic of the colonial past. It is now considered inappropriate to grant freehold title as this deprives the state of any future say in the ownership of the land unless it is acquired compulsorily".[23] Problems continued which needed to be addressed, particularly the attitude of financial institutions that favoured freehold property rights. Nonetheless, Botswana succeeded in achieving what was exceptional in sub-Sahara Africa simply because the British just did not covet a territory that was blighted by the Kalahari Desert. As a result, tribal property rights secure the individual's access to the community's land in the post-colonial era. Thus, *land was not a contested asset.*

There was, however, one risk: economic growth would result in the rise in the value of urban land. This could lead to the inequities that are the institutionalised cause of poverty in the West. Botswana addressed that issue.

> Government, tribe or state 'ownership' of the land in the ultimate, ensures that land values are increased if at all for the community's benefit and that community investment does not unevenly favour some individuals simply because they happen to own some land.[24]

Thus, social stability and economic growth were achieved *not* because of institutions that stressed *private* property rights. Rather, the success may be attributed to a more complex, sophisticated philosophy of property: the conjunction of individual *and community* rights in a form that harmonises private and social interests. Thus, in terms of our figure of property rights (on p. 47 above), Botswana would be located towards the north-west corner of quadrant A.

Botswana did not suffer a resource curse – of private corruption and public conflict – because rents, in the main, were reserved for the community's benefit. This was achieved because society preserved a customary sense of the right of everyone to share the riches of nature. The economic surplus would be diffused through the public sector while, through the tax system, the weakest burden possible was imposed on capital investment in private enterprise.

Two caveats need introduced. First, countries that are not rich in natural resources are *not* automatically disadvantaged compared to a country like Botswana (see box opposite).

Second, it would be a mistake to idealise the Botswana model and thereby overlook residual problems. We will identify one, the case of the Kalahari Bushmen (see box over). This illustrates how even an enlightened government can intrude on people's land rights – ostensibly in the name of the public good. This means that, unless the individual can enforce rights against government without those rights being manipulated, there is a risk of losing one's natural right of access to use land.

But the most important lesson to be carried out of Botswana comes from an incident that occurred at the critical historical juncture when the country became independent.

Rent & People-Power

ACCORDING to George Soros, drawing on the teachings of Jeffrey Sachs, "There is not much that one can do about bad location".* Wrong. Where nature is parsimonious, people-power can compensate. This is achieved by harnessing location to everyone's mutual benefit.

Most of Botswana's neighbours are not richly endowed by nature. Does this account for the poor performance of countries like Uganda and Zambia? The rent issue needs to be explored much more deeply, for resource-poor countries like Malawi and Uganda have riches of another kind: people.

People represent human energy and creativity. This *people power* can generate the surplus that is a rental value every bit as vital in raising living standards as the minerals buried beneath Botswana's territory. The major difference is that oil, diamonds and gold are finite resources. One day they will be exhausted. Rent created by the fusion of people-power is infinite. Particle for particle, rent generated by people as if from nothing is the most benign source of revenue. Those rents are most evident in towns, where people are willing to pay to occupy bare surfaces that have no attributes beyond their location.

With this knowledge, can we elaborate a model of growth that includes everyone's interests? Conventional economists and Western governments are aware of the key elements of that model, which would release the power of the billions who live in poverty. These people *could* generate creative energy sufficient to eclipse anything delivered by nuclear fission. But Western policy advisers, as they cruise the world's regions of deprivation, remain silent. You may find occasional traces of this knowledge in the academic literature, but where is the systematic effort to inform the people? Instead, emphasis is placed on the doctrines of the post-classical model of economics. This purposefully degrades knowledge of rent.** The consequence is institutionalised poverty, the corruption of culture, and civil wars.

* Soros (2004) p. 111 ** Gaffney and Harrison (1994)

This was the time of greatest vulnerability for the indigenous population in terms of the capacity to build a post-tribal politicised society that was capable of taking its place among the international community of nations.

Botswana then had a *per capita* GDP of $100. Would the people be free to enjoy the fruits of their natural resources in a sovereign state? Diamonds lay beneath the desert, and these could fund the services that would raise standards of health and welfare. But they lacked the technology to extract and market the diamonds, so they would need foreign assistance. In stepped de Beers, the South African diamond cartel. What happened then is told by Joseph Stiglitz in *Globalisation and its Discontents.*

> Shortly after independence, the cartel paid Botswana $20m for a diamond concession in 1969, which reportedly returned $60m in profits a year. In other words, the payback period was four months![25]

Unfortunately for de Beers, the government of Botswana then enlisted the help of a lawyer from the World Bank. He argued forcefully for a renegotiation of the contract. The mining interests were outraged. Under dispute was a huge flow of rental income.

> De Beers...tried to tell people that Botswana was being greedy. They used what political muscle they could, through the World Bank, to stop him [the lawyer]. In the end, they managed to extract a letter from the World Bank making it clear that the lawyer did not speak for the Bank. Botswana's response: That is precisely why we are listening to him.[26]

The dispute was resolved with the discovery of a second large diamond deposit. This enabled Botswana to renegotiate

Tribal Land Rights

THE Bushmen of the Kalahari Desert were immune from rent-seekers – until diamonds were discovered under one of their settlements. The government denied wanting to re-settle the hunter-gatherers to clear the way for mining. The Bushmen were sceptical. A legal battle secured them victory in 2006: under the Constitution, they were entitled to remain on their ancestral lands.

Chapter 2 of the Botswana Constitution protects people from being deprived of their land. Tribal property is also secured to prevent the National Assembly from enacting any law that might affect tribal organisation. The Bushmen thought that they could continue to use their hunting grounds following their legal victory. But the government decided to amend the Constitution by deleting a passage from the Chapter (paragraph 3(c) of Section 14). This provision affords protection by regulating entry into or residence within areas occupied by Bushmen. By deleting this clause, the government hoped to relocate the Bushmen, ostensibly to provide them with the social care that was not available in the middle of the desert.

The London-based Survival International argue that this legal ploy would not render the Bushmen vulnerable to dispossession of their territory – for Section 14 (1) reads: "No person shall be deprived of his freedom of movement...freedom [meaning] the right to move freely throughout Botswana, the right to reside in any part of Botswana..."

The Bushmen case is one of a growing list of legal test cases that protect traditional land rights in countries like Canada, Australia, South Africa and Malaysia. But uncertainties about the status of the rights of people who wish to live according to tribal customs stresses the need to resolve the property rights of everyone, including the first settlers on territories who wish to preserve their customary ways of life.

the whole commercial relationship with de Beers – to the mutual benefit of both parties.

In this episode we see how easy it would have been for Botswana to go down the route to mass poverty. It was the intervention of a "brilliant and dedicated lawyer", seconded to the government by the World Bank (which then denied him), which rescued the country from a predatory deal. Without that intervention, the extra millions of dollars would not have made much difference to the fabulous profits of the diamond cartel. But those rents made the difference between poverty and prosperity for hundreds of thousands of people in Botswana.

To lay the solid institutional foundations for growth and prosperity, the peoples of the neo-colonised world need to instruct their governments to undertake a renegotiation over their nation's rents similar to what happened in Botswana. For the redevelopment of their societies rests exclusively on coming to terms with a richer understanding of the meaning of rent as public value.