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U4 BRIEF

Tackling corruption in oil rich countries: The role of transparency

Corruption is a huge problem in many developing countries rich in oil and other natural resources, and is central in explaining why these countries perform badly in terms of socio-economic development. Transparency reform has recently been viewed as a key factor in addressing corruption and other resource-curse related problems. But what role does transparency actually play in tackling corruption in oil rich countries?

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Introduction

Countries rich in natural resources tend to perform badly in terms of socio-economic development. Despite the abundance of natural resources at their disposal, the economies of Nigeria and Venezuela, for example, grow slower than those of Korea and Taiwan, which lack this abundance.[1] This phenomenon is commonly referred to as the 'resource curse' and relates to a complex set of political, economic and social factors to be found in many resource rich countries.

Corruption is a key element in the overall resource curse landscape. It is a huge problem in many developing countries that are rich in oil and other natural resources, and is central in explaining why these countries perform so badly. Corruption in resource rich countries is often political and bureaucratic in nature, involving both abuse of office on the part of key decision-makers and corrupt acts among lower-level officials tasked with policy implementation.

Transparency has been viewed as an important factor in reducing corruption and other resource-curse related dysfunctions. Where timely and reliable information is accessible to all relevant stakeholders, it is said that at least some corruption risks may be mitigated. Indeed, there is a clear positive correlation between political transparency and control of corruption, indicating that more transparent countries are less corrupt.[2] The exact causal relationship between corruption and transparency, however, is an issue requiring further advanced research.

This U4 Brief [3] provides a short overview of the current state of knowledge on the relationship between transparency and corruption, with a particular emphasis on oil rich countries. It attempts to shed light on the role transparency – or, more accurately, access to information – plays in improving development outcomes in such countries, referring to the case of Angola and to current transparency initiatives such as the Extractive Industries Transparency Initiative (EITI).

Transparency, corruption and the resource curse: the case of Angola

The types of problems faced by oil rich countries where a lack of transparency in government is prevalent are clearly illustrated in Angola. As the second largest oil producer in Sub-Saharan Africa, the revenues from Angola's oil production are huge – accounting for 55% of its GDP, 94% of exports and some 80% of overall government revenue. Most major oil extraction companies and service firms are present in the country, and – uncharacteristically for a country considered to be cursed by its own resources – economic growth, led by a boom in the value of oil production, is high. At the same time, however, Angola has extremely poor income distribution and almost 70% of the population live on less than 2 dollars a day. Most Angolans, moreover, lack access to basic health care and life expectancy at birth is a mere 41 years. The low development impact of oil-led growth reflects, in part, minimal political effort to address distribution issues.

Set against this picture is that of a government highly unaccountable to its own population, where public decisions are not transparent. Public budgets in Angola are particularly opaque. The country scored 4 from a possible 100 percent on the Open Budget Index in 2006, indicating that the government provides scant or no information on the central government's budget and financial activities. Angola scores badly, too, in terms of political accountability. The last election took place in 1992, and the country ranks a low 172 out of 207 countries on Kaufmann's measure of voice and accountability.

Consistent with the large available resource revenues and poor, un-transparent institutional environment, Angola is a country perceived to be highly corrupt. It ranked 142 out of 163 countries on Transparency International's Corruption

Perceptions Index in 2006, and 182 out of 203 countries on Kaufmann's Control of Corruption Index in 2005. Angolan citizens lack trust in their government, their media and, according to a survey of potential voters undertaken by the International Republican Institute, even their friends.[4] Such lack of trust is part of an overall culture of secrecy in the country cultivated over nearly 30 years of civil war.

What does a lack of transparency do in oil rich countries?

There is common agreement that good institutions matter in addressing corruption and other development problems in resource rich countries. Transparency is considered an important prerequisite for establishing proper institutional and regulatory structures, and for creating the conditions in which abuses can be challenged. Understanding how transparency relates both to corruption and to broader resource-curse issues, however, requires that we explore how information affects decision-making in oil rich countries.

As an illustration, consider the following: a public official collecting tax revenue from the oil sector can choose either to be honest or corrupt. If honest, the official will report the factual costs of the oil company and receive compensation in terms of a fixed wage. If corrupt, the official will receive a bribe in addition to the wage. The official is likely to make the choice that results in the best overall personal outcome. This, in turn, will depend on a number of factors including the level of the official's wage, the amount of the offered bribe and the probability of being caught. From such a simple example, it should follow that a large bribe, low wages and a lack of enforcement are all factors that stimulate corruption.

A lack of transparency makes corruption less risky and more attractive

Transparency will have a direct impact on detection of any wrongdoing: the more transparent the cost structure of the company, the more difficult it will be for the official to cover their tracks. A lack of transparency may also have an impact on law enforcement, both by making proof more difficult to generate and by allowing corrupt officials the option of buying their way out of punishment.

A lack of transparency makes it harder to use incentives to make public officials act cleanly

A lack of transparency will make it more difficult to know exactly what factors influence the official's decision. Because these factors are unclear, it will also be more difficult to implement policies to reduce corruption. Where a government seeks to provide incentives for honest behaviour, a lack of transparency can impede observation of the actual impact of incentive systems. In the above example, the official in question will be better informed of their actions than the, relatively uninformed, government. The government can only observe the outcomes of the agent's actions. The more 'noise' or 'interference' related to these actions, the more difficult it will be for the government to base appropriate incentives on them and, thus, reward clean behaviour.

A lack of transparency makes it harder to select the most honest and efficient people for public sector positions or as contracted partners

Different public officials and private sector actors will have different levels of integrity, but since honest governments will have imperfect information, identifying honest and efficient officials or contract partners will be difficult. Two solutions to this problem can be envisaged: officials can signal their honesty through, for instance, some kind of certification scheme, or alternatively, the government can design a screening process through which honesty or dishonesty is revealed. To the extent that transparency can be assumed to reduce asymmetric information about the characteristics of officials or partners, it increases the probability of selecting the 'right' type of official or partner. In the case of an oil rich country, this would mean selecting the most cost-effective oil companies and government officials with the highest competence and discretion.

Informational advantages give access to rents, making reform difficult

Corrupt governments in oil rich countries would forego huge rents if they implemented reform increasing access to information. In the above example, the public official in question gains from their informational advantage, suggesting that information capture is in their interests. Indeed, information problems may be perpetuated where large appropriable revenues are at stake. Where the government controls information, voters are also less likely to sanction bad behaviour as they are less likely to be able to identify bad policies in the first place. The point is that information capture – whether by an individual public official or an entire government – influences political outcome. Transparency, on the other hand, reduces the possibilities for rent-seeking behaviour and increases accountability.

A lack of transparency makes cooperation more difficult to sustain, and opportunistic rent-seeking more likely

Information is central to facilitating and sustaining cooperative behaviour. In the oil industry, oil companies commonly relate to several public sector bodies, such as the ministry of finance and the national oil company. Windfall gains such as those from natural resource revenues make it more lucrative for individual actors to deviate from cooperative agreements to, for example, spend revenues on public goods, in order to privately appropriate a part of the revenues. An absence of transparency may exacerbate problems of reaching and sustaining cooperative social arrangements, intensifying the detrimental effect of natural resource revenues.

A lack of transparency may undermine social norms and reduce trust

Transparency is also related to social norms. Several studies suggest that the extent to which it pays to be corrupt depends on whether others are corrupt. Where corruption is widespread, this means that it is also highly persistent, as small changes in the number of corrupt individuals are unlikely to make others follow suit. Social norms against corruption may be hard to uphold in the absence of information, since it is hard to establish mechanisms for punishing corrupt behaviour.

Transparency alone is not enough

A lack of transparency can exacerbate corruption related problems in oil rich countries and there is empirical evidence suggesting that transparency is associated with less corruption.[5] The effect of transparency on corruption is not unconditional, however, and the ability to process and act on information is also required for corruption to be addressed.

Education is required to process information

A certain level of education is needed for a population to process information and there is evidence that the effect of transparency on corruption is conditional on education. There is, in particular, empirical evidence that the effect of press freedom on corruption is dependent on education levels.[6] Resource rich economies, however, often engender economic structures that are not conducive to the formation of skills. Where the resource sector is dominant, there will be little transition towards industrialisation and the creation of a large skilled labour force. Rather, there will be a large unskilled workforce in primary production, and a smaller skilled and politically favoured labour aristocracy in the resource sector. The result is large income inequalities and low social capital accumulation, causing political conflict and obstructing institutional development.

> *"The effect of transparency on corruption is not unconditional [...] the ability to process and act on information is also required"*

Government accountability must be present

Having information on the conduct or performance of public officials is of little use if other actors are unable to punish abuses of office. Indeed, the issue of democratic accountability is an important and particularly problematic one in oil rich countries. Several studies show that countries with high revenues from oil are less democratic. Ross finds that oil's harmful influence extends beyond the traditional heartland of the Middle East to countries such as Indonesia, Malaysia, Mexico and Nigeria.[7] This is frequently attributed to the so-called rentier effect whereby governments can reduce pressures for democratisation through patronage. Similarly, where oil revenues are high, there is less need for taxation and hence less pressure for political representation from the population. Finally, governments may use oil revenues to repress or obstruct the formation of groups independent of the government.

The 'right' incentives for information use are needed

The effect that information has depends very much on the incentives that individuals have to act upon it. Olken shows that local participation in village road projects in Indonesia changed only the form of corruption, not its overall level.[8] In the villages where participation was increased, there was reduced theft of villagers' wages, but this was offset by a corresponding increase in the theft of building materials. Providing information is therefore likely to be effective for activities that involve private goods, such as wages, but likely to be ineffective in the provision of public goods such as infrastructure. This has implications for the type of information provided to the population in oil rich countries, since providing highly aggregate macroeconomic figures on oil revenues or expenditures is likely to provide only weak individual incentives. An alternative could be to make public information on district or individual entitlements, and the extent to which these are met. Some caution is advisable, however, in targeting information to topics of private interest as this may feed into the negative process of patronage and clientilism.

What should be the focus of transparency reform?

Transparency is undoubtedly important for addressing corruption in oil rich countries. But, in certain circumstances, it can also be a double-edged sword. Information is power and this power can potentially be used to gain access to revenues generated by natural resources. Policy reform that purportedly enhances access to information can, for example, be instrumentalised by political leaders to prioritise outcomes that benefit certain interest groups. Even where there is significant political will for genuine reform, the concept of transparency is complex and multi-faceted, providing substantial room for manipulation and circumvention.

Transparency may relate to a number of public sector activities, from the collection of public revenues, through to the awarding of contracts and to public sector promotions. Those designing transparency reform therefore need to consider the coverage, prioritisation and sequencing of reform measures to increase access to information. So far, however, there has been little research into what issues should be prioritised by would-be reformers.

One argument is that transparency reform in oil rich countries should focus on those areas that most effectively address resource curse issues. Prominent explanations of the resource curse see institutions as a key factor in its avoidance. Institutions capable of making the private sector function efficiently via the development of sound rule of law and bureaucratic efficiency are, for example, key to making entrepreneurs choose productive private sector employment over unproductive rent-seeking activities. Moreover, institutions that limit the ability of governments to distribute public sector positions to political supporters can also help avoid overall distortion of the allocation of resources in the economy. Most current reform initiatives, however, have tended to focus on transparency in other areas.

A prominent current reform process is the Extractive Industries Transparency Initiative (EITI), which supports improved governance in resource-rich countries through verification and publication of company payments and government revenues from oil, gas and mining. This is a voluntary initiative whose underlying motivation is that mechanisms to collect, distribute and use extractive industry revenues should be clear and acceptable to all. The EITI focuses in particular on transparency in revenue collection. Since substantial amounts are believed to disappear in the process of collection, this is no doubt an important aspect of addressing extractive resource governance. The EITI, however, provides only a partial basis for accountability in the management of extractive resources in so far as it does not address transparency in their use i.e. the expenditure www.U4.no

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side. Patronage politics, where resource revenues are used to buy political support, is an important aspect of the resource curse. This issue is not covered by the EITI and it is likely, therefore, that the initiative needs to be coupled with other types of reform to have an effect on corruption in oil rich countries.

Conclusion

There is currently strong support for transparency among donors and other policy-makers, and several initiatives – including EITI – have sought to increase access to information in oil rich developing countries. This U4 Brief has outlined some of the key aspects of transparency measures in resource rich contexts, based on a more extensive U4 Issue Paper on this topic. A main finding of this initial research is that focusing on transparency is only one of several policy options to address corruption in oil rich countries, and may need to be complemented by other reform initiatives.

Transparency can have an effect on corruption in oil rich contexts. It can make bureaucratic corruption more risky, make it easier to provide good incentives to public officials and ease selection of honest and efficient individuals for the public service. Transparency can also help reduce political corruption by increasing overall public accountability. Further, it can facilitate cooperative behaviour instead of opportunistic rent-seeking, helping to maintain norms of integrity and trust.

Transparency has an effect on corruption, however, only in certain circumstances. Its impact depends on the ability of individuals to process and act on the information provided. Transparency reform, therefore, depends in turn on levels of education, the power of key stakeholders and the nature of the goods about which information is given.

Though transparency can have an effect on corruption, this does not imply that increasing access to information should receive the highest priority in addressing corruption in oil rich countries. Arguably, priority should be given to the types of reform that have the greatest impact on reducing corruption and/or alleviating the resource curse. This may involve focusing on increasing the profitability of the productive sector or improving the institutions that govern companies. From this perspective, the effectiveness of transparency reform should, at the very least, be more systematically evaluated at country level, vis-à-vis other policy options.

If transparency in some form is sufficiently important to merit priority, this raises the question of what forms of transparency to promote and how. Current approaches tend to focus on transparency in public revenues. Given the centrality of public expenditure in patronage politics in oil rich countries, this focus is not necessarily the most effective for addressing corruption. Further detailed analysis of the various modes of transparency, the mechanisms by which they matter, and the ways in which they can be implemented, is needed to better inform policy in this area.

Links and resources

- U4 Anti-Corruption Resource Centre's Natural Resource Management and Corruption theme page www.U4.no/themes/natural-resources
- Isaksen, J., Amundsen, I., Wiig, A., with Abreu, C. (2007). Budget, State and People: Budget Process, Civil Society and Transparency in Angola, July 2007 Bergen: CMI www.cmi.no/publications/publication/?2706=budget-state-and-people-budget-process
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- Kolstad, I. (2007), The resource curse: Which institutions matter? 2007 Bergen: CMI http://www.cmi.no/publications/publication/?2678=the-resource-curse-which-institutions-matter
- Extractive Industries Transparency Initiative resource center http://eitransparency.org/resource/center
- Publish What You Pay NGO Coalition resources webpage http://www.publishwhatyoupay.org/english/resources/index.shtml

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