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A CRITICAL STUDY OF THE RESOURCE CURSE THESIS AND THE EXPERIENCE OF PAPUA NEW GUINEA

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in May 2010

for the degree of Doctor of Philosophy in the School of Law, Faculty of Law,
Business and Creative Arts
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Abstract

According to the *resource curse thesis* (RCT) of the 1990s, a strand of development discourse informed by neoliberal development economics, natural resource-rich developing countries are *cursed* by their natural resources abundance, particularly minerals and petroleum. Based on comparative statistics collected from the 1970s to the 1990s, the resource curse theorists claim that natural resources-rich developing countries have performed very poorly in terms of economic growth leading to industrialisation and improvement in social welfare compared to resource-poor developing countries at similar stage of development such as Singapore, Taiwan and South Korea. The resource curse theorists argue that, contrary to the assumptions of modernisation theory of the 1940s and 1950s that natural resources abundance would lead to rapid capital accumulation that would then lead to rapid industrialisation and usher in a stage of sustained economic growth, resource-rich developing countries have experienced regressive economic growth trends, systemic corruption, civil wars, political instability, and general decline in the standard of living and social wellbeing. The resource curse theorists thus assume that resource-poor developing countries prospered because they pursued ‘free market’ and export-oriented policies such as open trade while resources-rich developing countries sought ‘autarkic’ (heavily regulated) policies that led to their regression. Therefore, these theorists conclude that the solution to the resource curse is ‘free market’ policies epitomised by the Washington Consensus.

This thesis critically examines the RCT from a political economy standpoint and establishes that the resource curse *effects* are the same outcome described by political economists in the 1950s and 1960s as the *underdevelopment of development*. The

difference in the choice of words to describe the same effects stems from the ideological standpoint from which Third World poverty and underdevelopment is discussed. To the resource curse theorists viewing from the standpoint of neoliberalism, internal factors such as political corruption, rent seeking, lack of transparency and good governance cause the resource curse. To the political economists on the other hand, external factors such as the volatility of world commodity prices, capital flight, tax evasion, colonialism, imperialism, neocolonialism and globalisation cause underdevelopment.

This thesis establishes that both external and internal factors contribute to the poverty and underdevelopment of Third World countries. One of the external factors is the legal regime imposed through colonialism. Colonial laws have effectively divested indigenous peoples of their ownership and property rights in natural resources, which the neo-colonial nation-states retained upon independence, which are then transferred to transnational corporations in exchange for licence fees and non-controlling equity. Local ruling elites and foreign capitalists share the resources wealth, leaving the majority impoverished and their countries underdeveloped. Chapters 10 and 11 examine Papua New Guinea's legal regime to demonstrate this point.

The thesis concludes that the solution to the resource curse or underdevelopment is for natural resources-rich developing countries to reform their laws to allow majority ownership and control in their citizens and adopt policies that the now developed countries adopted and followed when they were at similar stage of development. These policies are the 'autarkic' policies rejected by the resource curse theorists but recommended by the political economists of the underdevelopment discourse.

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ABREVIATIONS

AFRODAD	African Forum Network on Debt and Development
AIAE	African Institute for Applied Economics
AoA	Agreement on Agriculture
APF	Alaska Permanent Fund
AusAID	Australian Aid and International Development
BCA	Bougainville Copper Agreement
BCCI	Bank of Credit and Commerce International
BGFLA	Business Group for Latin America
BI	Business International
BIS	British Intelligence Service
BP	British Petroleum
BSA	Benefits Sharing Agreement
BSR	Benefits Sharing Regime
CDOs	Collateralized Debt Obligations
CC	Control of Corruption
CIA	Central Intelligence Agency (US)
CIC	China Investment Corporation
CIDA	Canadian International Development Agency
CIPA	Country Policy and Institutional Assessment
CIPE	Centre for International Private Enterprise
CIS	Centre for Independent Studies
CPC	Constitutional Planning Committee (PNG)
CPS	Centre for Pensions and Superannuation
CRA	Conzinc Riotinto of Australia
DRC	Democratic Republic of Congo
ECA	Enhanced Cooperation Agreement (Australia & PNG)
ECAs	Export Credit Agencies
EFIC	Export Finance and Insurance Corporation (Australia)
EIR	Extractive Industries Review
EITI	Extractive Industries Transparency Initiative
EHM	Economic Hit Man
EIC	Expenditure Implementation Committee
EPI	Export-Promotion Industrialisation
EU	European Union
EURODAD	European Network on Debt and Development
FAO	Food and Agriculture Organization
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GE	Government Effectiveness
GIC	Government of Singapore Investment Corporation
GNP	Gross National Product
GRICS	Governance Research Indicator Country Snapshot
HDI	Human Development Indicators

HLLG	Hulia Local-Level Government
IAEA	International Atomic Energy Association
IBP	International Budget Project
IDA	International Development Association
IDPE	international development policy establishment
IFIs	International Financial Institutions
IGOs	Intergovernmental Organisations
IMF	International Monetary Fund
IOB	Iranian Oil Bourse
IPBC	Independent Public Business Corporation
IPD	Initiative for Policy Dialogue.
IRI	International Republican Institute
ISI	Import-Substitution Industrialisation
ITIC	International Tax and Investment Centre
ITT	Industrial, Trade and Technology
JECOR	U.S.-Saudi Arabian Joint Economic Commission
KDA	Kutubu Development Agreement
KIC	Korea Investment Corporation
KSPA	Kutubu Special Purpose Authority
LBD	Learning-by-Doing
LNGP	Liquefied Natural Gas Project
MDA	Moran Development Agreement
MDTF	Multi-Donor Trust Fund
MHA	Member of the House of Assembly
MNCs	Multinational Corporations
MP	Member of Parliament
MRA	Minerals Resources Authority
MRDC	Mineral Resources Development Company
NAFTA	North American Free Trade Agreement
NBIM	Norges Bank Investment Management
NED	National Endowment for Democracy
NDCs	Now Developed Countries
NDI	National Democratic Institute
NFRK	National Fund for the Republic of Kazakhstan
NGC	National Gas Corporation Limited
NGDP	National Goals and Directive Principles
NGOs	Non-governmental Organisations
NPT	Nuclear Nonproliferation
OBI	Open Budget Initiative
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries
OSJI	Open Society Justice Initiative
OSCs	Observance of Standards and Codes
PDL	Petroleum Development Licence
PNGBC	Papua New Guinea Banking Corporation
PNG	Papua New Guinea
PNGSDP	Sustainable Development Program Limited

PPA	Power Purchase Agreement
PRK	Petroleum Resources Kutubu
PRM	Petroleum Resources Moran
PSAs	Production-Sharing Agreements
PSC	Production-Sharing Contract
PV	Political Instability and Absence of Violence
PWYP	Publish What You Pay
RCT	Resource Curse Thesis
RL	Rule of Law
ROSF	Russian Oil Stabilization Fund
RQ	Regulatory Quality
SAMA	Saudi Arabian Money-laundering Affair
SAPs	Structural Adjustment Programs
SHP	Southern Highlands Province
SHPG	Southern Highlands Provincial Government
SML	Special Mining Lease
SOFA	Status of Forces Agreement
SOF	State Oil Fund
SWFs	Sovereign Wealth Funds
TJN	Tax Justice Network
TNCs	Transnational Corporations
TWN	Third World Network
UN	United Nations
UNDP	United Nations Development Program
UNCLA	United Nations Commission for Latin America
UNCTAD	United Nations Conference on Trade and Development
US	United States of America
USAID	U.S. Agency for International Development
UR	Uruguay Round
VA	Voice and Accountability
WBG	World Bank Group
WTO	World Trade Organisation.
WW II	World War II

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Australia
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Development Agreement Relating to the Central Moran Petroleum Development Project between the Independent State of Papua New Guinea and the Moran Project Area Landowners, Hulia Local-level Government and the Southern Highlands Provincial Government

North Atlantic Free Trade Agreement

PNG LNG Project Umbrella Benefits Sharing Agreement between the Independent State of Papua New Guinea and the Southern Highlands, Gulf, Central, and Fly River Provincial Governments, South Koroba, North Koroba, Hayapuga, Komo, Hulia, Lake Kutubu, West Kikori, West Hiri and Nomad Local-level Governments and the Project Area Landowners.

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Preface

Generally, the law, policy and events discussed in this thesis are stated as at 31 December 2008, although in some instances global developments during the first half of 2009 are included. This reflects the fact that the draft thesis was completed by the end of 2008, while the first half of 2009 was spent on editorial work, structure and arrangement of the thesis.

Every effort has been made to edit and ensure that spelling is English/Australian and not American, but there may still be instances where American spelling may have evaded my attention.

Style citation, including the bibliography, is the Melbourne University standard, which is the standard adopted by the School of Law, James Cook University.

CHAPTER ONE

INTRODUCTION

I. THE ISSUE AND REASON FOR THIS STUDY

Papua New Guinea (PNG) is a developing country with abundant natural resources. Because of its minerals boom in the 1980s and petroleum discoveries and production in the 1990s, many observers have described the country as 'a mountain of gold floating on a sea of oil'.[1] Conventional wisdom and modernisation theory suggest that the mineral and petroleum resources should benefit the country and its people. Yet, there is a great paradox, when the conventional indicators of economic wealth are compared to those of social well-being, the comparison shows that the economic benefits from the extraction of its rich minerals and petroleum are not flowing to PNG and its people.[2] According to an AusAID assessment in 2004:

> Papua New Guinea is in a serious social and economic crisis. Overall…living standards are worsening, the population is increasing rapidly, the resource base is being depleted, income-earning opportunities are decreasing, access to services and transport infrastructure is declining, the infrastructure itself is deteriorating and

---

[1] This statement was first made by the then Minister for Mining and Petroleum of the PNG government in 1992: Dan Kennedy reported this in *Habitat Australia* (August, 1996) p.21. The *World Reporter – Papua New Guinea*, dated 31 January 2004, had the heading, *A mountain of gold floating on a sea of oil* in its mining section on page 8, in describing the mining projects and mining potential in PNG.

[2] Bill Standish, 'Papua New Guinea Politics: Attempting to Engineer the Future' (December 2002) 60 *Development Bulletin* p.28; Anne Dickson Waiko, 'Civil Society and Development, Non-Government Organizations and Churches' (October 1999) 50 *Development Bulletin* p.44; Augustine J. Mungkaje, 'Coastal Fisheries Development in Papua New Guinea: An Opportunity for Economic Development in Coastal Communities' (October 1999) 50 *Development Bulletin* p.37; Samuel Kriss Koyama, 'Black Gold or Excrement of the Devil? The Externalities of Oil Production in Papua New Guinea' (2005) 20 (1) *Pacific Economic Bulletin* p.14; Michael Manning, 'Papua New Guinea Thirty Years On' (2005) 20 (1) *Pacific Economic Bulletin* p.145; Henry Okole, 'Institutional Decay in a Melanesian Parliamentary Democracy: Papua New Guinea' (December 2002) 60 *Development Bulletin* p.37.

> effective government support is uncommon… The crisis has built up over a long period. The need for effective intervention is now pressing.[3]

The 2005 United Nations Development Program's (UNDP) annual Human Development Indicators (HDI) presented an assessment based on indicator data illustrating the very poor state of the social and economic well-being of PNG's people on a global scale. Out of 177 countries surveyed, PNG's position is shown as follows:

Table 1.1

Development Indicator	***Rank***
• Overall placement	137 out of 177.
• Life expectancy (at 55.3)	139 out of 177.
• School enrolment: 41% (of total population)	158 out of 177.
• GDP per capita (A$2,619, or K651)	116 out of 177.
• Human poverty	78 out of 103.
• Building the capabilities of women	103 out of 140.

Mike Manning, director of the Institute of National Affairs in Port Moresby, and his co-author, Susan Windybank, editor of *Policy*, the quarterly magazine of the Centre for Independent Studies (CIS), provided the following assessment in 2003:

- For most of PNG's five million people, living conditions have barely improved since independence. Windfall mining revenues and generous levels of aid have subsidized a small political elite at the expense of investment in roads, education and health. Deficit financing and government borrowing for unproductive spending have left little money for key state institutions such as the police, legal system and armed forces. Violent crime rates are soaring, law and order have broken down, and PNG cannot effectively monitor and defend its land and sea borders.

---

[3] The Commonwealth Government of Australia (AusAID), *Enclaves or Equity: The Rural Crisis and Development Choice in Papua New Guinea* (2004) p.ix.

- Population growth is high but economic growth is negligible so that the country is going backwards. Job creation is totally inadequate. The build-up of unemployed young people, particularly in urban areas, leads to demoralisation, social breakdown, escalating crime and civil unrest. The extent of lawlessness scares off investors and tourists, reinforcing a downward spiral whereby no jobs are created and law and order get worse.

- This decline is accelerating. In the past, PNG has always muddled through despite grim economic conditions and dire prognosis because people could fall back on subsistence farming and local market to survive. But this social safety net now appears to be disintegrating under the impact of crime, which has spread to villages. The resulting hardship is taking its toll on traditional village life, fuelling urban drift.[4]

The foregoing represents unanimity among development observers that PNG is facing serious economic and social problems. Why? What causes the paradox of plenty? This question has influenced me to research and write this thesis.

II. CONTESTING THEORETICAL EXPLANATIONS

My search for answers to this question led me to three paradigms of development discourse. These three contesting discourses grapple with the general question: *What causes poverty and 'underdevelopment', or 'backwardness,' in the Third World?* This question has provoked academic debate among social scientists, led by development economists, since the emergence of Third World nations out of the colonial territories of the Western Powers after World War II (WW II).[5] From the

---

4 Susan Windybank and Mike Manning, 'Papua New Guinea on the Brink' (March 2003) 30 *Issue Analysis* p.1.

5 Early development theorists used the phrase 'backward areas' or 'underdeveloped areas' instead of 'Third World': see H.W. Arndt, *History of Development Studies 4: 50 Years of Development Studies* (1993) p.3; James Baster, 'Recent Literature on the Economic Development of Backward Areas' (1954) 68 (4) *The Quarterly Journal of Economics* pp.585-602; George W. Hoffman, 'The Problem of Underdeveloped Regions in Southeast Europe: A Comparative Analysis of Romania, Yugoslavia and Greece' (1967) 57 (4) *Annals of the Association of American Geographers*, pp.637-666. Development theory proper is generally understood to have originated in the 1940s and 1950s from 'modernization' studies: see Remy Herrera, 'The Neoliberal 'Rebirth' of

vast body of literature on this issue, the three paradigms of development discourse from their historical order of development are, the *modernisation school* largely informed by orthodox and Keynesian economics; the *underdevelopment school* based on political economy history and interpretation of the emergence and global expansion of the capitalist economic system; and the *neoliberal school* informed by liberal political philosophy, particularly the libertarian strand, and neoclassical economics.[6]

According to the modernization discourse of the 1940s and 1950s, Third World 'backwardness' was caused by deficits in the factors of production: most had abundant land and labour but insufficient capital.[7] It was assumed that 'States with abundant natural resources could most easily overcome these capital shortfalls, thanks to both their ability to export primary commodities and their attractiveness to foreign investors.'[8] The *staple theory*, one of the leading theories on modernisation, used the Australian, Canadian and American experiences to argue that, capitalizing on their comparative advantage, Third World countries such as PNG that were endowed with rich natural resources like minerals and petroleum would experience rapid economic

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Development Economics' (2006) 58 (1) *Monthly Review* pp.1-14; Jorge Larrain, *Theories of Development: Capitalism, Colonialism, and Dependency (*1989); Charles P. Oman and Ganeshan Wignaraja, *The Postwar Evolution of Development Thinking* (1991); Richard Peet and Elaine Hartwick, *Theories of Development* (1999); Diana Hunt, *Economic Theories of Development: An Analysis of Competing Paradigms*, (1989); Colin Leys, *The Rise & Fall of Development Theory* (1996). For the meaning of 'development economics', see Giorgio Secondi (ed), *The Development Economic Reader* (2008) p.1.

6 Cf Amartya Sen, 'Development: Which Way Now?' in Rajani Kanepalli Kanth (ed), *Paradigms in Economic Development* (1994) ch. 12, p.211, for the meaning and discussion on the origin of development economics. Hollis B. Chenery, 'The Structuralist Approach to Development Policy' (May 1975) 65 (2) *The American Economic Review* pp.310-316; Albert O. Hirschman, 'The Rise and Decline of Development Economics' in Hirschman (ed), *Essays in Trespassing: Economics to Politics and Beyond* (1981) pp.1-4. Andre Gunder Frank also provides three classifications but to him slightly defers: *neo-classical* (right), *Keynesian* (centre) and *Marxist* (left): see 'The Underdevelopment of Development' in Sing Chew and Robert Denemark (ed), *The Underdevelopment of Development: Essays in Honour of Andre Gunder Frank* (1996) ch. 2.

7 William Arthur Lewis, *The Theory of Economic Growth* (1955).

8 Michael L. Ross, 'The Political Economy of the Resource Curse Thesis' (1999) 51 (2) *World Politics* pp.297-322; Lewis, id., at p.258; Oman and Wignaraja, above n1, at p.7.

growth and industrialization as transnational corporations (TNCs) invest in these sectors and provide economic linkages, employment, government revenue, infrastructure, and transfer technology and skills.[9] Revenues from natural resources would then enable governments of these countries to embark on well-specified linear stages of industrialisation that will ultimately lead to a self-sustained stage of growth.[10]

The *underdevelopment school* of the 1950s through the 1970s disagreed and argued that Europe's accumulation of wealth and prosperity was caused by the exploitation of labour and natural resources in the colonial territories.[11] Indigenous peoples in these territories were dispossessed of their lands and title to natural resources by the colonial powers for their enrichment.[12] The decolonisation process merely converted the colonial territories into neocolonial nation-states through which the former colonial powers used various means to continue extracting wealth from the former colonies for their benefit.[13] While exploitation through colonialism was direct and achieved through formal methods of control like the implementation of administrative structures, the stationing of military forces, and the incorporation of the natives as

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[9] See Harold A. Innis, *The Cod Fisheries: The History of an International Economy*, (1940); Albert O. Hirschman, *The Strategy of Economic Development* (1958); Harvey Leibenstein, *Economic Backwardness and Economic Growth* (1957); David Grant, 'The Staple Theory and Its Empirical Measurement', (1974) 82 (6) *The Journal of Political Economy* pp. 1249-1253; M. Altman, 'Staple Theory and Export-led Growth: Constructing Differential Growth' (2003) 43 (30) *Australian Economic History Review* pp.230-255.

[10] Walt Whitman Rostow, *The Stages of Economic Growth* (first published 1966, 1990 ed).

[11] Andre Gunder Frank, 'The Development of Underdevelopment,' in James D. Cockcroft, Andre Gunder Frank and Dale Johnson (eds), *Dependence and Underdevelopment* (1972); Andre` Gunder Frank, *Capitalism and Underdevelopment in Latin America: Historical Studies of Chile and Brazil* (1967); Andre` Gunder Frank *Latin America: Underdevelopment or Revolution: Essays on the Development of Underdevelopment and the Immediate Enemy* (1969).

[12] Christopher Chase-Dunn, *Global Formation: Structures of the World-Economy* (1989) p.39; Kema Irogbe, 'Globalization and the Development of Underdevelopment of the Third World' (Spring 2005) 22 (1) *Journal of Third World Studies* p.41, at p.42.

[13] Theotonio Dos Santos, 'The Structure of Dependence' (May 1970) IX, 2, (2)*, American Economic Review: Papers and Proceedings*, p.231.

subjects of the metropolitan government,[14] neocolonialism is an indirect form of control of former colonies through the ruling native elites compliant with neocolonial powers, where populations are exploited for their labour, and resources extracted in order to feed an insatiable appetite for finished physical or cultural commodities made by the metropole.[15] Decolonization also signaled a new mode of colonization not through political intervention but through a relatively small number of big integrated industrial and financial firms, which effectively lock the Third World into the international political economy structure to serve the interests of these industrial powers.[16] Independence hence created a system of dependency and exploitation 'a kind of post-imperialism imperialism, or what has been called "dominance-dependence".'[17] Political and military might of the industrialised Powers protect and perpetuate this monopoly and *dominance-dependence* structure.[18] Poverty and underdevelopment are the natural consequences of this unequal relationship in international political economy.

The *resource curse thesis* (RCT), a strand of the neoliberal school, disagrees with both schools of thought. To the underdevelopment school, it argues that if Third

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14 J. I. Dibua, *Modernization and the Crisis of Development in Africa* (2006).

15 Ling Yew, 'Neocolonialism: Political Discourse: Theories of Colonialism and Postcolonialism' (2002); Ankie M. M. Hoogvelt, *The Third World in Global Development* (1982) p. 169. Hoogvelt describes national leaders as passive 'national bourgeoisie' who do not have the courage to disentangle their economy from domination, but instead, team up with foreign capital in serving capitalist interests.

16 Harry Magdoff, *The Age of Imperialism: The Economics of U.S. Foreign Policy* (1969) p.27; Immanuel Wallerstein, *The Modern World-System: Capitalist Agriculture and the Origins of the European World-Economy in the Sixteenth Century, Volume I* (1974).

17 Douglas A. Yates, *The Rentier State in Africa: Oil Rent Dependency and Neocolonialism in the Republic of Gabon* (1996) p.41. See also Carlos Johnson, 'Dependency Theory and the Processes of Capitalism and Socialism' (1981) 8 (3.4) *Latin American Perspectives* pp.55-81; Louis A. Perez, Jr., 'Dependency' (1990) 77 (1) *The Journal of American History* pp.133-142; Ronald H. Chilcote, 'Issues of Theory in Dependency and Marxism' (1981) 8 (3.4) *Latin American Perspectives* pp.3-16. Richard Vengroff, 'Dependency, Development and Inequality in Black Africa' (1977) 20 (2) *African Studies Review*, pp.17-26.

18 J. W. Smith, *Economic Democracy: The Political Struggle of the Twenty-first Century* (4th ed, 2005).

World countries were poor economies dependent on the rich Northern economies, or if the rich North was continuing to exploit the poor Southern peripheral economies, the 'Asian Miracle' would not have occurred. However, the 'Asian Miracle' conclusively proves that Third World underdevelopment is caused by factors other than the *dominance-dependence* structure of the so-called unequal relations in the international political economy. To the modernisation school, the RCT points out that countries like Taiwan, Singapore, and South Korea are natural resources-deficient compared to natural resources-endowed Latin American and African countries. Yet, the resources-rich countries lagged behind, while the resources-deficient countries progressed and prospered. Moreover, during the mineral and oil booms of the 1970s and 1980s, the oil and mineral-rich countries like Mexico, Venezuela and Nigeria, among others, accumulated huge foreign debt instead of huge savings, effectively disproving the assumptions of modernisation theory. Therefore, the existing evidence suggests that natural resources 'curse' the developing countries that are endowed with them.[19]

According to the RCT, effects of the resource curse are manifested in low or regressive economic growth and poor social performance, lack of 'good governance', weak institutions, environmental pollution, and civil conflicts in the natural resource-rich developing countries.[20] Generally, governments of resources-rich developing

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[19] Richard M. Auty, *Sustaining Development in Mineral Economies: The Resource Curse Thesis* (1993); Richard M. Auty, *Economic Development and Industrial Policy: Korea, Brazil, Mexico, India and China* (1994); Richard M. Auty, *Patterns of Development: Resources, Policy and Economic Growth* (1995).

[20] Jeffrey D. Sachs and Andrew M. Warner, 'Natural Resource Abundance and Economic Growth', (National Bureau of Economic Research Working Paper Series – Working Paper No. 5398, Harvard Institute for International Development, 1995); Sachs and Warner, 'The Curse of Natural Resources' (2001) 45 *European Economic Review*, p. 828; J. Goodman and D. Worth, 'The Mineral Boom and Australia's "Resource Curse"'(2008) 61 *Journal of Australian Political Economy* pp. 201-219; Global Witness, *Oil and Mining in Violent Places: Why Voluntary Codes for Companies Don't Guarantee Human Rights* (2007).

countries are characterized by a government that is corrupt, weak, repressive and undemocratic such as the oligarchic feudal monarchy of Saudi Arabia,[21] the dictatorial regimes in Nigeria,[22] Indonesia,[23] and Venezuela,[24] or as failing nation-states such as Angola and PNG.[25] The argument goes that resources abundance under such regimes exacerbates endemic proneness to civil conflicts as happened in PNG over the Bougainville copper mine[26], the 'blood diamond' mines of Angola, Sierra Leone, and the Democratic Republic of the Congo,[27] the Nigerian oil conflicts,[28] and the separatist movement in Banda Aceh,[29] and West Papua in Indonesia.[30]

Neoliberalism is an 'ideology that seeks to justify the structuring of the economy to increase opportunities for private profit, often couched in the language of "market freedoms" and "individual choice".'[31] As such, it is not surprising that the RCT suggests that if natural resources-endowed developing countries adopt 'market-

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21 Pascal Menoret, *The Saudi Engima: A History* (Beirut: World Book Publishing, 2005).

22 P. Chudi Uwazurike, 'Confronting Potential Breakdown: The Nigerian Redemocratisation Process in Critial Perspective' (1990) 28 (1) *The Journal of Modern African Studies* pp.55-77.

23 Michael R. J. Vatikiotis, *Indonesian Politics Under Suharto: The Rise and Fall of the New Order* (1st published 1993, 1998 ed).

24 Terry Lynn Karl, 'Petroleum and Political Facts: The Transition to Democracy in Venezuela' (1987) 22 (1) *Latin American Research Review* pp.63-94.

25 J.S. Migdal, *Strong Societies and Weak States: State-Society Relations and State Capabilities in the Third World* (1988); G. Myrdal, 'The 'Soft State' in Underdeveloped Countries' (1967) 15 *University of California at Los Angeles Law Review* pp.1118-1134.

26 Paul Collier, (Director, Development Research Group of the World Bank), 'Economic Causes of Civil Conflict and their Implications for Policy' (Washington D.C.: World Bank, 15 June 2000) available online at http://www.worldbank.org/research/conflict/papers/civilconflict.pdf <Accessed 10.09.07>.

27 Aleisha Stevens and David Carment, 'Commerce and Conflict: Angola and Diamond Works: Final Report' (Country Indicators for Foreign Policy (CIFP) Project, The Norman Paterson School of International Affairs, Carleton University, June 2005). Christian Dietrich, 'Hard Currency: The Criminalized Diamond Economy of the Democratic Republic of Congo and Its Neighbours', (Occasional Paper No.4, Partnership Africa Canada, Ottawa, June 2002).

28 Human Rights Watch, 'Nigeria: The Price of Oil: Corporate Responsibility and Human Rights Violations in Nigeria's Oil Producing Communities' (January 1999).

29 Norwegian Refugee Council and Internal Displacement Monitoring Centre (IDMC), 'Indonesia: Support Needed for Return and Re-integration of Displaced Acehnese Following Peace Agreement: A Profile of the Internal Displacement Situation' (IDMC, 19 July 2006).

30 Global Witness, *Paying for Protection: The Freeport Mine and the Indonesian Security Forces* (Global Witness, Washington, D.C., July 2005).

31 Frank Stilwell, *Political Economy: The Contest of Economic Ideas* (2002) p.390.

friendly' policies, they would avoid or escape the curse.[32] This suggestion is based on comparative studies that are claimed to reveal that resources-rich Latin America, which pursued government planned and protected import-substitution industrialization, suffered the curse and lagged behind the natural resources-poor 'Asian Miracle' countries like Taiwan, Singapore and South Korea, which pursued open trade and export-oriented policies.[33] The basic assumption is that resources-rich developing countries are cursed only if and when they refuse to follow export-oriented and 'free market' development policies.

The purpose of this thesis is to critically examine the underpinning ideological assumptions of the 'resource curse thesis' (RCT) in order to ascertain its relevance to the PNG experience. The RCT has become an important tool in the analytical repertoire of some development economists, the international financial institutions (IFIs) and intergovernmental organisations (IGOs) and resources-rich developing countries that these organisations advise because it provides an explanation for the lack of growth that does not need to address the exploitative process of unequal patterns of trade and investment underpinned by military and other forms of geopolitical power that have prevailed between the economic North and South over the last 500 years, which is exposed by the underdevelopment discourse. Instead, the explanation for the lack of growth is shifted back to the resources-rich yet poor developing countries themselves.

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32 Auty (1993), above n 19.
33 Auty (1993 and 1995), above n 19.

III. THESIS PROPOSITION

Informed by critical political economy of underdevelopment, this thesis posits that capitalism and the current neoliberal development paradigm produce underdevelopment in the Southern periphery for the benefit of the Northern economic core through an unequal exchange regime, which allows Northern capital to hold exclusive title to exploration and production of natural resources in resources-rich developing countries. The political economies of the North are the primary beneficiaries of underdevelopment while poverty and state failure beset the resourcse-rich developing states from which they extract their wealth. In the case of PNG, colonial mining and petroleum legal regimes, which were inherited by the neocolonial PNG nation-state upon political independence from Australia in 1975, extinguished traditional property rights in these resources and enabled the transfer exclusive exploration and production titles to transnational corporations, which consequently causes underdevelopment or the resource curse. The resource curse discourse, however, blames the victim in order to obfuscate the devastating effects of capitalist exploitation, unequal exchange, underdevelopment and environmental destruction, thus serving as an ideology protecting the 'free market' as well as public governance practices that protects these exclusive natural resources property regimes that perpetuate the effects of the so-called resource curse.

This proposition also stems from a critical analysis of the nature of capitalism as an economic system. This thesis holds that, as Aristotle proposed, *capitalism* is the *unnatural* or *monetized* economy compared to the *natural* or *non-monetized*

economy.[34] According to Aristotelian economics, money is used in the natural economy for the limited needs of the household, whereas in the unnatural economy money is acquired for *accumulation* as an end in itself, or to acquire political and military *power* in order to facilitate further accumulation.[35] The unnatural economy requires that individuals engage in stiff competition against one another to accumulate wealth either legally or illicitly without regard to the harmful consequences such self-interested competition might bring on others or the environment.[36] Under a natural economy, collective interests prevent or place a check on competitive spirits of individualism.[37] Under capitalism, however, neither collective concern nor limited natural resources hinders the quest to satisfy unlimited individual wants. This unrestrained economic system promotes individual self-interest leading to accumulation of obscene wealth by the strongest few, while the vast majority live in poverty.[38] Neoliberalism not only promotes this type of unfair economic system, but also upholds it as a model for developing countries to follow.[39]

The resource curse thesis, however, ignores the fact that under capitalism the gain of a person or a country corresponds to the loss of another person or a country. The one who lost, or from whom wealth has been taken, experiences poverty and underdevelopment, while the one who gained becomes prosperous and powerful.[40] The RCT ignores that in a capitalist economic system there is a natural and

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[34] Richard Seaford, 'Aristotelian Economics and Athenian Tragedy' (2000) 31 *New Literary History* pp.269-276.

[35] Id., at p.269.

[36] Clara Nieto, *Masters of War: Latin America and U.S. Aggression* (2003); Chalmers Johnson, *The Sorrows of Empire: Militarism, Secrecy, and the end of the Republic* (2004); Arnold Kukari and Erica Ogoba, 'The Hegemony and Enigma of Modern Development' (October 1999) 50 *Development Bulletin* pp.54-55.

[37] In the Hela society in Papua New Guinea where I come, for instance, accumulation is shunned whereas sharing and caring are held in esteem.

[38] J.W. Smith, *Money: A Mirror Image of the Economy* (revised 2nd ed., 2008).

[39] See Michel Chossudovsky, *The Globalization of Poverty and the New World Order* (2nd ed, 2003).

[40] Magdoff, above n 16 at p. 27; See generally Smith, above n18.

inseparable equation between *gaining* and *losing* or *accumulation* and *poverty*.[41] These two faces of capitalism are experienced among different groups of people in a single country as was experienced earlier in North America and Western Europe before the emergence of colonial territories as independent nation-states[42], or as it is happening now due to the sub-prime mortgage-triggered financial crises in these countries, or as is experienced by marginalized members of developed countries such as the Aboriginal Australians, Canadian Indians and New Zealand Maoris.[43] Since development economics deals with development trajectories of developing countries rather than individuals and communities within a country, the focus of this thesis is on international political economy relations among nation-states rather than groups and individuals within nation-states.

There is stiff competition among nation-states for the control of finite sources of raw materials, especially minerals and petroleum, as exemplified by the United States' constant interventions in Latin America, or Iraq and Afghanistan since 2003 under the pretext of pursuing terrorists.[44] Because of their superior skills, knowledge and technological advantage, as well as financial wealth and military power, it is not surprising that the industrialized countries of the North end up controlling the rich natural resources in the weak nations of the Southern periphery.[45] To legitimize and perpetuate this control, development discourse originating from the rich North use their history and privileged position to lecture developing countries on how to become developed like they are by adopting the development policies propagated by their own

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41 See Clive Hamilton, *Growth Fetish* (2003).

42 Henry George, *Progress and Poverty: An Inquiry into the Cause of Industrial Depressions and of Increase of Want with Increase of Wealth: The Remedy* (1912).

43 Paul Havemann (ed), *Indigenous Peoples' Rights in Australia, Canada and New Zealand* (1999).

44 See Oystein Noreng, *Crude Power: Politics and the Oil Market* (2006); Greg Grandin, *Empire's Workshop: Latin America, the United States, and the Rise of the New Imperialism* (2006) p.167.

45 Smith, above n 18.

intellectuals.[46] In this thesis, such development 'lectures' are not designed to make developing countries prosperous and become industrialized, because in a competitive capitalist economy it would be foolish on their part to enrich their rivals and, conversely, impoverish themselves. Rather, the policies are designed to trap developing countries in a vicious cycle of debt and dependency and 'kick away the ladder' that would lead them to become 'industrialized'.[47]

For this reason, this thesis argues that development policies produced by many Northern intellectuals for consumption by the Southern periphery such as the 'free market' policies of the RCT perform ideological functions. Ideology is used here to mean *the ruling ideas of the ruling class of a given epoch* as expressed by Karl Marx and Frederick Engels in *The German Ideology*.[48] Marx and Engels employed ideology to represent the production of ideas, concepts and consciousness, which function as the superstructure of a civilization.[49] From Burke[50] and Eagleton's[51] exposition on the nature and meaning of ideology as used by Marx and Engels, several points deserve careful attention. First, an ideology encompasses all ideas produced in the minds of human beings, ideas and concepts like law, politics, economics, religion, morality, democracy and so on. Second, ideology functions as the superstructure of a civilization: the conventions and culture that make up the dominant ideas of a society. Third, ideas that form ideology as in the first sense that

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[46] John Perkins, *Confessions of an Economic Hitman: The Shocking Inside Story of How America Really Took Over the World* (first published 2004, 2005 ed.).

[47] Ha-Joon Chang, *Kicking Away the Ladder: Development Strategy in Historical Perspective* (2003).

[48] Marx, Karl and Frederick Engels, *The German Ideology, Part One, with Selections from Parts Two and Three, together with Marx's 'Introduction to a Critique of Political Economy'* (2001 ed.).

[49] Dino Felluga. 'Modules on Marx: On Ideology', *Introductory Guide to Critical Theory*, 28 November 2003, online at http://www.purdue.edu/guidetotheory/marxism/modules/marxideology.html. <Accessed 31.10.07.

[50] Heather Burke, *Meaning and Ideology in Historical Archaeology: Style, Social Identity, and Capitalism in an Australian Town* (1999) pp. 11-16.

[51] Terry Eagleton, *Ideology: An Introduction* (1991) pp.28-30.

become the superstructure of a civilization in the second sense do not come from all human beings but only from the ruling class: hence, what Marx and Engels call the 'ruling ideas of the ruling class'. Ideology is superimposed to give it a structure and meaning, which then serves to direct political, social and economic activities. Fourth, the ruling ideas are the ideal expression of the dominant material relationships. Fifth, therefore, the ideas of the ruling class become the ideas of dominance, control and subjugation. Sixth, the overriding goal of ideology is to legitimize the ruling ideas in a position of hegemony, and perpetuate obfuscation of violence and exploitation of the ruled and disempowered group in society. Seventh, an ideology therefore effectively creates the assumption that the ruling hegemonic idea is natural and desirable.

This thesis argues that the RCT performs an ideological role to legitimize the hegemonic positions of the former colonial powers and transnational corporations that fund and control the exploitation of mineral and hydrocarbon resources in the former colonial territories and obfuscate the harmful economic, social and environmental effects of their activities by blaming 'wrong' policies and government interference in the 'perfect' operation of the so-called 'free market'.

By advocating 'market-friendly' policies, the RCT also obfuscates the economic and social devastation wrought through the following three key political economy eras:

- era of colonialism and imperialism – 15th -20th century;
- era of decolonization and neocolonialism – mid 20th to late 20th century; and
- the globalization era – late 20th century to the present.

Each of these eras reveals the devastation wrought by exploitation and continued maintenance of unequal economic and political power relations between the developed political economies of the economic North and developing countries and regions of the economic South. Through the processes of colonialism and imperialism, Western powers exploited and plundered the wealth of the colonies. As Peet and Hartwick observe:

> Europe's development was predicated on active underdevelopment of the non-European world. … Europe's development was based on external destruction: brutal conquest, colonial control, and the stripping of non-Western societies of their peoples, resources and surpluses. From historical processes like this came a new global geography of European First World centre and non-European Third World periphery. The relationship between the centre and the periphery assumed…spatial form of dependence, in which some countries (the dominant) achieved self-sustaining economic growth, while the others (dominated and dependent) grew only as a reflection of changes in the dominant countries.[52]

After decolonization, the former colonial powers continue to exploit labour and natural wealth from their former colonies through the globalization of 'free market' policies epitomized by what is called the *Washington Consensus*.[53] The term 'consensus' emerged from the unanimous agreement of the Washington D.C. development establishment, which includes the International Monetary Fund (IMF), the World Bank and the United States Treasury Department, on ten specific set of policies as a *one-size-fits-all* recipe to promote 'free market' capitalism in Third World countries in the name of solving poverty by promoting growth. Implementation of the ten policies shown in the table below during the last three

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52 Peet and Hartwick, above n5, at p.107.

53 Malcolm Crick, 'Entangled Lives and Meanings: Colonialism and Its Cultural Legacy' in Bill Geddes and Malcolm Crick (eds), *Global Forces, Local Realities: Anthropological Perspectives on Change in the Third World* (1997) p.63.

decades, however, inflicted severe poverty and annihilated any gains that were made during the modernization era under Keynesianism.[54]

Table 1.2

Washington Consensus

- Fiscal discipline.
- Minimal government intervention in the economy to redirect public expenditure priorities towards fields offering both high economic reforms and the potential to improve income distribution, such as primary health care, primary education, and infrastructure.
- Tax reform (to lower marginal rates and broaden the tax base).
- Interest rate liberalization.
- A competitive exchange rate.
- Trade liberalization.
- Liberalization of inflows of direct foreign investment.
- Privatization.
- Deregulation (to abolish barriers to entry and exit).
- Secure property rights.

According to Harvey, these policies, often imposed in developing countries in the form of *structural adjustment programs* (SAPs), have caused 'accumulation by dispossession' and widened the gap between the few ruling political and capitalist elites and the vast majority during the last thirty years.[55] In other words, the SAPs have caused more wealth from the poor Southern periphery to flow to the rich Northern industrial centres, while causing wealth-producing assets to be concentrated in a few ruling elites in both regions. Therefore, this thesis views that the unfinished business of colonialism and imperialism disrupted by World War II and decolonisation have been pursued through neocolonialism and globalization of the Washington Consensus. The emergence of capitalism, which caused colonialism and imperialism, has undergone reproduction to cause neocolonialism and globalization. Third World poverty and underdevelopment, therefore, reflect one side of the global capitalist system. Vadana Shiva captures this view in the following words:

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[54] Naomi Klein, *The Shock Doctrine: The Rise of Disaster Capitalism* (2007).

[55] David Harvey, *The New Imperialism* (2003).

> The poor are not those who have been 'left behind'; they are the ones who have been robbed. The wealth accumulated by Europe and North America are largely based on riches taken from Asia, Africa and Latin America. Without the destruction of India's rich textile industry, without the takeover of the spice trade, without the genocide of the native American tribes, without African slavery, the Industrial Revolution would not have resulted in new riches for Europe and North America. It was this violent takeover of Third World resources and markets that created wealth in the North and poverty in the South.[56]

Tom Palmer holds a similar view when he observes: '*Capitalism requires the existence of poverty to function. Without a poor underclass to exploit, the wealth that capitalists brag about cannot be created. Globalization is all about finding new pockets of poor people to take advantage of. If poor people ceased to exist, it would be the end of capitalism as we know it.*'[57] From this standpoint, this thesis argues that the RCT serves as an ideological tool of the ruling capitalist elites who fund and promote neoliberal development discourse to legitimize as well as obfuscate the devastation wrought by their enrichment.

IV. STRUCTURE OF THE THESIS

Chapter Two

Since the aim of this thesis is to examine what causes poverty in the midst of abundant natural resources in developing countries generally, and in particular in PNG, through a critical study of the explanations proffered by RCT, Chapter Two traces the origin of the RCT and establishes that it is informed by neoliberal economics. The chapter shows that neoliberalism developed as an anti-Keynesian economics paradigm, which was not popular until the United States government, at

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[56] Vandana Shiva, 'Two Myths That Keep the World Poor', online at http://www.odemagazine.com/article.php?aID=4192 <Accessed 4 June 2007>.

[57] Tom Palmer, 'Capitalism, Exploitation and Globalization', online at http://www.tomgpalmer.com/archives/009857.php. <Accessed 05.11.07>. Emphasis added.

the behest of its transnational corporations operating in Latin America, employed it to protect and pursue their profit interests. Because the RCT holds up Chile's 'free market' reforms as a model for other resource-rich developing countries to follow in order to solve the 'curse' of resource abundance, the chapter traces how neoliberal theory was first implemented in that country in the 1970s by the Chicago University's Department of Economics during the military regime of General Augusto Pinnochet. The chapter also examines how the RCT gained popularity.

Chapter Three

Chapter Three provides an exhaustive examination of the various causes and explanations for the occurrence of the resource curse provided by orthodox resource curse theorists under four general headings: legal causes and explanations, economic causes and explanations, political economy causes and explanations, and socio-cultural causes and explanations. The chapter critically evaluates each of these explanations and discusses their relevance to the experiences of PNG.

Chapter Four

Chapter Four reviews *underdevelopment economics* literature to demonstrate that the so-called resource curse effects of the RCT are nothing more than the very political economic effects underdevelopment economics pointed out long before the emergence of the RCT. This is to say that only semantic differences separate description of the same legal, political and socio-economic effects. However, the intellectual prisms through which the same effects are analysed and the policies prescribed to resolve the effects are based on different ideologies. The chapter hopes to demonstrate that had the RCT not been driven by 'free market' ideology but

genuine concern to redress Third World poverty and underdevelopment, then it would have adopted the policies prescribed by underdevelopment economics instead of prescribing liberal policies that throw poor Third World countries into further poverty and economic dependence. The chapter also hopes to establish the relevance of underdevelopment economics to understanding the experience of PNG from a comparative standpoint with the explanations advanced by the RCT.

Chapters Five and Six

Of eight main policies prescribed by orthodox resource curse theorists to solve or avoid the resource curse, Chapter Five dissects the first four policies while Chapter Six looks at the other four, and critiques each of these policies from underdevelopment economics standpoint in general and the experiences of PNG in particular. The aim of both chapters is to show that most of the policies prescribed are those that the now developed countries did not follow in order to become rich and industrialised, but nevertheless prescribed to developing countries because they serve their interests. As such, most of these policies are not relevant to PNG.

Chapters Seven

This chapter examines several international movements by well-meaning civil society groups, research think-tanks, intergovernmental organizations, international financial institutions, and transnational corporations to redress the resource curse. The chapter questions whether these movements are global ‘Good Samaritans’ or self-interested capitalists. After a careful analysis of the various programs of these movements, the chapter concludes that there are elements of both benevolence and self-interest. The overall aim of the chapter is to demonstrate the global importance of the RCT and

how it has caused global action within a globalized neoliberal structure. However, these movements dwell on transparency and good governance and fail to address the legal causes that are critical to resolving underdevelopment in natural resources-rich developing countries like PNG.

Chapters Eight and Nine

The aim of these two chapters is to discuss political economy causes and explanations provided by underdevelopment economics avoided by the resource curse theorists. Chapter Eight argues that capital flight is one of the key causes of Third World nations' natural wealth dispossession. Implementation of the Washington Consensus policies, the chapter argues, has exacerbated the unrestricted flow of capital out of developing countries. Chapter Nine adds that neocolonial policies such as political destabilization and regime change in order to put in place governments that are compliant with the interests of the metropolitan Powers cause the resource curse. The chapter discusses past and recent case examples from Latin America to Africa, and from Asia to the Middle East on regime change and political destabilization. The ultimate aim of the chapter is to demonstrate that those developing countries that have adopted legal regimes and policies that threaten to sever the *dominance-dependence* structure are destabilized and overthrown through overt and covert operations by the Northern Powers.

Chapters Ten and Eleven

Chapter Ten examines the legal causes of the resource curse through different ownership regime types. The chapter demonstrates that the type of mineral and petroleum ownership regime that PNG inherited from the Australian colonial

government has, and is causing, 'accumulation by dispossession' in PNG. Chapter Eleven examines the current legal regime on sharing minerals and petroleum resources development benefits. The aim of the two chapters is to show that the explanations for Third World poverty and 'backwardness' offered by the legal explanations of the RCT and the underdevelopment school is proven to be true in the case of PNG. The chapter argues that PNG should adopt the policies suggested by the underdevelopment school to redress its resource curse instead of the 'market-friendly' policies proffered by the RCT.

Chapter Twelve

This chapter summarises the preceding eleven chapters and provides a conclusion, with some policy suggestions alternative to the orthodox policies.

V. METHODOLOGY

The method of analysis of the PNG experience and critique of the RCT is from a political economy standpoint. Since debate on Third World development is dominated by economists, one is led to believe that only economic reasons seem to matter. This study begs to differ from that view. It believes that there is a strong connection between law and economics, and politics and power. In fact, the classical view of political economy from Adam Smith, Karl Marx and others after them focus on the relationship between law, wealth, politics and power. This is quite clear from Adam Smith's definition of political economy as *a branch of the science of a statesman or legislator* that proposes two distinct objects:

> first, to provide a plentiful revenue or subsistence for the people, or more properly to enable them to provide such a revenue or subsistence for themselves; and secondly, to

> supply the state or commonwealth with a revenue sufficient for the public services. It proposes to enrich both the people and the sovereign.[58]

Political economy, as the *science of the legislator* to provide for the subsistence of the people and the nation-state, concerns laws governing the welfare of both the *ruled* and the *rulers*.

The definition provided by Alfred Marshall also emphasise the connection between *man* and *society* unlike orthodox economists who treat economics as an abstract science. To Marshall, political economy or economics is the 'study of mankind in the ordinary business of life; it examines that part of individual and social action which is most closely connected with the attainment and with the use of material requisites of wellbeing'.[59] Marshall does not divorce the *social* from the study of economics like most neoliberal economists do today by taking the *law of demand and supply in the marketplace* as being controlled by the natural law of the invisible hand.[60] Therefore, adopting Marshall's definition, *the study of mankind in ordinary business* should properly entail the study of law and politics, which humankind in ordinary business engages in, and power which law and wealth confer.

In this respect, Robert Gilpin's definition of *international political economy* is instructive. According to Gilpin, international 'political economy… means the reciprocal and dynamic interaction in international relations of the pursuit of wealth

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[58] Adam Smith, *An Inquiry Into the Nature and Causes of the Wealth of Nations*, (first published 1776, 1952 ed) p.182.

[59] Alfred Marshall, *Principles of Economics: An Introductory Volume*, (8th edn., first published 1890, (1962,) p.1.

[60] Lindy Edwards, *How to Argue with an Economist: Reopening Political Debate in Australia* (2002) p.36.

and the pursuit of power.'[61] This means '*on the one hand, the distribution of power creates patterns of property rights within which wealth is produced and distributed; on the other hand, changes in productive efficiency and access to resources affect relations of power in the long term. The interaction between wealth and power is dynamic because both wealth and power are continually altered, as are the connections between them.*'[62] This dynamic nature of wealth and power in the international political economy is reflected well by the changes in international politics and power, which caused colonialism, decolonization and neocolonialism, and globalization. The three paradigms of development economics reflect the dynamic nature of this relationship between law, wealth and power. Hence, wherever actors exert power over one another in an economy, the economy is political.[63]

Minerals such as uranium and oil resources are undeniably political and military weapons as well as economic assets.[64] When nation-states enact laws to claim absolute title in all hydrocarbon and minerals within their political domain, it involves the use of power to suppress and deny competing claims from traditional landowners who hold title to the surface, as is the case in PNG, or necessitates regime change as the U.S. has effected in Iraq. Competing claims over natural resources between a nation-state and societies within it, or between nation-states, or between a nation-state and multinational corporations occur because of the power and wealth natural resources can confer. As Keohane observes: 'The complementarity of wealth and power provides a thread of continuity between the world political economy of the

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[61] Robert Gilpin, *U.S. Power and the Multinational Corporations: The Political Economy of Foreign Direct Investment* (1975) p.43.

[62] Robert O. Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy* (1984) p. 18. Emphasis added.

[63] Ibid.

[64] Daniel Yergin, *The Price: The Epic Quest for Oil, Money and Power* (1991).

seventeenth century and that of today.'[65] Jacob Viner's description of this wealth and power relationship then and now is spot on:

> 1) Wealth is an absolutely essential means to power, whether for security or for aggression; 2) power is essential or valuable as a means to the acquisition or retention of wealth; 3) wealth and power are each proper ultimate ends of national policy; 4) there is a long-run harmony between these ends, although in particular circumstances it may be necessary for a time to make economic sacrifices in the interest of military security and therefore also of long-run prosperity.[66]

Another dimension of the wealth and power relationship entrenched by law can be analysed from ascertaining who has *control* and *ownership* of the wealth-producing assets. The question focuses not only on *who owns* but also *who controls* the extraction, distribution and use of rich natural resources in developing countries. This involves questions of politics and law because politicians make laws and policies on the questions of ownership, control and use. Since political power is 'the power to control the machinery of the state or to influence government policy,' political power can be acquired and used by those who own and control wealth-producing assets to protect and promote their interests.[67] In other words, politicians may get power through democratic processes through the ballot, but those who own and control the means of wealth production can also wield political power to influence government policy and law, as is ably demonstrated by the experience of PNG.

Hence, because of the obvious connection between politics, power, natural resources and law, I am of the view that only a political economy approach to the study of PNG's paradox of plenty in particular, and similar developing countries in general,

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[65] Keohane, above n 62, at p.23.

[66] Jacob Viner, 'Power Versus Plenty as Objectives of Foreign Policy in the Seventeenth and Eighteenth Centuries' (1948) 1 (1) *World Politics* pp.1-29, at p.10.

[67] Robert W. Cox, *Production, Power and World Order: Social Forces in the Making of History* (Volume 1 in the four-volume series on *Power and Production*, 1987) p.18.

can provide a balanced view. Moreover, the overwhelming silence of the RCT on the connection between law, politics and power in the competition for control over the earth's finite natural resources, particularly hard-rock minerals and oil, makes the political economy approach all the more relevant to appreciate PNG's development dilemma.

It is true that studying 'political economy is not easy: indeed, the emphasis on competing currents of economic thought and their association with rival political philosophies adds complexity to the subject'.[68] But 'there are rich rewards as similarities and differences across the various disciplines are encountered and as the theories and methods developed in one or more disciplines are seen as appropriate to others'.[69] I hope that is so here.

VI. CONCLUSION

After decolonization and political independence, former colonial territories like PNG have been subjected to vigorous studies on how they could become industrialised like their former colonial powers. One of the key ideas was that they needed capital to launch into industrialization on the assumption that an industrialized economy represented progress as opposed to 'backwardness'. For those countries that were endowed with rich natural resources, exploitation of these resources with foreign capital would enable rapid accumulation necessary to embark their industrialization trajectories. Underdevelopment economics, based on history and personal experiences by those who lived in developing countries, especially Latin America, argued that the extraction of natural resources by foreign capital would not cause

[68] Stilwell, above n 31 at p. 9.
[69] Norman T. Feather, *Values in Education and Society* (1975) p. 1.

capital accumulation but capital flight leading to underdevelopment. According to the RCT, the promise of modernization theory that natural resources would lead to capital accumulation, which would then cause growth and progress, has failed. Instead, natural resources have become a curse for those developing countries that are endowed with them.

In this thesis, I argue that the RCT is wrong on this point because modernisation theory did not promise that natural resources endowment will cause growth and development, but transnational corporations extracting natural resources like minerals and petroleum would enable capital to be accumulated, leading to growth. This means the curse effects vindicate underdevelopment theory. Therefore, it is not natural resources that have cursed developing countries, but foreign capital has exploited and displaced developing countries of their natural resources wealth. In that sense, the legal explanations of the RCT is correct to point out that natural resources laws that confer majority shares to foreigners cause the curse. That is true in the case of PNG, as Chapters Ten and Eleven will demonstrate. But, according to this thesis, the resource curse theorists' argument that the failure to adopt policies and legal regimes against the 'free market' has caused regressive growth trends over several decades, is wrong. While this thesis critiques the 'free market' stance of the RCT, it accepts its legal causes and explanations as being relevant to understanding PNG's underdevelopment.

CHAPTER TWO

THE RESOURCE CURSE THESIS, ITS ORIGIN AND EXPANSION

INTRODUCTION

This chapter traces the origin of the resource curse thesis (RCT) and follows its development through a survey of the relevant literature. The purpose of the chapter is to critique the RCT from a critical political economy perspective that is grounded in Third World values and experience in general and the experience of Papua New Guinea (PNG) in particular. This perspective enables a critique to be mounted that will explain the limited relevance to PNG values of the neoliberal discourse which has influenced academic analysis and the practice of international financial institutions (IFIs) and aid agencies over the last two decades in dictating Third World law and development policies.

The RCT provides a neoliberal critique of the modernisation theory based on Keynesian economics, which calls for a larger government role in the economy to stimulate growth, especially in times of depression and recession. The RCT also serves as a neoliberal critique of underdevelopment economics, which prescribes import-substitution industrialisation and domestic infant industry protection policies in favour of free trade policies. The RCT advocates the adoption of neoliberal policies that require *market-friendly structural changes* and *effective market-conforming interventions* as the standard prescription to solve the ‘resource curse’ of resources rich developing countries.

In this chapter Section I examines the origin of the RCT. Within the context of other competing economic theories, Section II locates the RCT as an ideological offshoot of

neoliberal economic theory by establishing the connection between how the theory was first experimented in Chile during the dictatorial regime of Augusto Pinochet in the 1970s and the Chilean model the RCT holds up for other developing countries to follow. Section III examines how the RCT was popularised, and Section IV provides a conclusion.

I. THE ORIGIN AND DEVELOPMENT OF THE RESOURCE CURSE THESIS

Richard Auty first introduced the resource curse thesis in his 1993 book *Sustaining Development in Mineral Economies: The Resource Curse Thesis*.[1] The opening sentences in that book read:

> The conventional view concerning the role of natural resources in economic development has been that the resource endowment is most critical in the early low-income stages of the development process. It assumes that, as development proceeds and a population acquires more and more skills, those skills are deployed with increasing effectiveness to counteract any resource deficiency (Ginsburg 1957).[2]

He continues:

> However, a growing body of evidence suggests that a favourable natural resource endowment may be less beneficial to countries at low- and mid-income levels of development than the conventional wisdom might suppose. Two important pieces of evidence are the developing countries' postwar industrialization efforts and the

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[1] Paul Stevens, in 'Resource Impact – Curse or Blessing?: A literature Survey' (London: Centre for Energy, Petroleum and Mineral Law and Policy, University of Dundee, March 2003), traces the use of the term 'resource curse' by Auty under a pseudonym 'David Brook' in an Arab trade press published in Beirut in early 1975, but that publication remained obscure until the publication of his 1993 book.

[2] Richard M. Auty, *Sustaining Development in Mineral Economies: The Resource Curse Thesis*, (London and New York, Routledge, 1993) p.1. Auty is professor of Geography at Lancaster University, United Kingdom.

> performance of the mineral-rich developing countries since the 1960s. The new evidence suggests that not only many resource-rich developing countries fail to benefit from a favourable endowment, they may actually perform worse than less well-endowed countries. This counter-intuitive outcome is the basis of the resource curse thesis.[3]

From a neoliberal economics standpoint, Auty presents two sets of evidence in support of his thesis that natural resources abundance is a 'curse' to developing countries that are endowed with them. The first set of evidence is collated to support the neoliberal critique of government involvement in economic planning and development, while the second set of evidence is tailored to suggest that adoption of neoliberal policies espoused by the Washington Consensus would solve the resource curse. These two themes are clearly evident in Auty's exposition of his resource curse thesis.

The first evidence Auty presents is based on a comparative study of larger industrialising countries such as China, India, Brazil and Mexico with smaller resource-deficient countries like South Korea and Taiwan. Auty argues that although all six countries were pursuing *autarkic* (i.e. strongly self-sufficient) *industrial policies* in the 1950s informed by Keynesian and underdevelopment economics, Taiwan and Korea abandoned those policies in favour of more 'free market'-oriented industrial policies in 1958 and 1963, respectively. Because Korea and Taiwan are resource-deficient, they were not able to earn sufficient foreign reserves to support their *inward-looking*, *infant industry promotion* (autarkic) industrial policies for a longer period than the larger newly industrialising countries. Taiwan and Korea therefore reverted to competitive manufactured exports sooner than China, India, Brazil and Mexico in order to overcome their foreign exchange deficiencies. These larger industrialising countries (China, India, Brazil and Mexico)

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[3] Ibid.

faced foreign exchange constraints as a result of their *autarkic industrial policies* in the 1960s. However, they faced difficulties in reforming these policies because entrenched powerful interests that benefited from the rents accruing from the protected infant industries put up stiff resistance. As a consequence, Auty reasons, rent-seeking behaviour of powerful vested interests favouring autarkic industrial policies delayed competitive industrialisation and slowed economic growth.

Auty provides further evidence in his book about *mineral economies*, represented by Bolivia, Peru, Jamaica, Zambia and Papua New Guinea, compared to Chile. Auty defines *mineral economies* as those developing countries which generate at least 40 percent of their export earnings from the mineral sector. Mineral economies comprise two main sectors: hydrocarbon producers and hardrock mineral exporters. Referring to earlier studies, Auty asserted that mineral economies' economic growth and their social welfare were inferior to those of non-mineral economies at a similar level of development.[4] He suggests that this is a counter-intuitive finding since compared to resource-deficient developing countries, mineral incomes provide the resource-rich developing countries with additional foreign exchange, taxes and an extra route to industrialisation. 'That additional route is via resource-based industrialization which is the downstream processing of the ore into metal and finished products,' writes Auty.[5]

Auty advances three factors which explain the lack of resource-based industrialisation compared to other resources-deficient developing countries like Korea and Taiwan. These factors are:

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[4] Auty, id., at p.3 cites G. Nankani, 'Development Problems of Mineral Exporting Countries' (World Bank Staff Working Paper 354, World Bank, Washington DC, 1979).

[5] Id., p.3.

- the nature and function of the mining sector;
- domestic linkages; and
- mis/management of mineral rents.

The first factor stems from the highly technical and capital-intensive nature of mineral production. That is, large foreign capital input is required, but the work employs a small number of nationals in the total workforce. Hence, we have capital flight and the outflow of income from foreign workers. The second factor stems from the enclave nature of mineral projects, which provides only limited local linkages. For example, few local factories are built to further process the ore before it is exported. These two factors explain why a larger portion of mineral revenue goes out to the foreign sources of capital, while only a small portion remains in the national economy, and further, why there is little transfer of technology, skills and capital into the local host economy.[6] The third factor is a result of the existence of substantial mineral rents captured by the host government through taxation, which destabilizes the local economy through 'Dutch disease'[7] and rent-seeking behaviour[8], which neoliberal economists view as very costly to governments because it restricts competition and earns no return.

It is useful to point out at this stage that the RCT does not discuss and examine policies that could possibly prevent or resolve the first two factors of the resource curse of mineral economies. While acknowledging that foreign capital investment in the mineral and petroleum sectors fails to generate significant economic linkages beneficial to the host country's development trajectories as well as causing capital flight, the RCT fails to

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[6] Ibid.
[7] The concept 'Dutch disease' is fully examined in Chapter Three.
[8] Auty, above n 2., at p.3. The rent-seeking concept is fully explained in Chapter Three.

examine policies that could prevent this happening. Instead, the focus is entirely on the third factor, which blames governments of developing countries for their dilemmas, and maintains that they need to switch to 'market-friendly' policies.

This partial stance is revealing in Auty's study of the six mineral economies (Bolivia, Peru, Jamaica, Zambia and PNG, compared to Chile), the subjects of his seminal 1993 book. Auty focuses on macroeconomic policies of these countries that he claims failed to prepare for external mineral price shocks of the 1970s and 1980s by ensuring sustainable management of resource revenue. During boom years, Auty asserts, these mineral economies failed to:

- allow competitive diversification in the manufacturing and agricultural sectors;
- put in place stabilisation funds to save money during boom years to meet budget shortfalls during down-swings; and
- abandon populist and structuralist efforts to redistribute income in favour of orthodox 'market conforming' policies.

Auty's policy conclusion for five of the six mineral economies is interesting. In the case of PNG, he finds that PNG managed its mineral booms and their down-swings quite well in the years 1973-74 before independence, and in the years 1979-82 and 1987-89, after gaining independence from Australia.[9] Auty cites three reasons for this: (1) the slow withdrawal of Australian aid; (2) successful renegotiation of the Bougainville Copper Agreement (BCA) without deterring foreign investment; and (3) establishment of a

[9] Id., at p.218.

mineral stabilisation fund to cushion revenue swings.[10] However, contrary to his prescriptions, PNG had failed to diversify into non-mining tradeables. Auty therefore argued that to stimulate diversification into non-mining tradeables, PNG required *macroeconomic reforms* and *structural changes*. Auty's diagnosis and prescription was:

> PNG's pre-occupation with medium-term economic problems and political fragmentation caused successive governments to neglect long-term structural deficiencies. *The colonial legacy of a high exchange rate, high public spending and wage indexation needed reform in order to speed growth of non-mining tradeables and reduce the mineral sector's role to that of an economic bonus.* Where such structural problems combined with poor macroeconomic management, then the outcome could be disastrous, as the experience of Zambia demonstrate…[11] (Emphasis added).

Auty fails to discuss how *structural changes* and *macroeconomic reforms* would cause diversification into the non-mining tradeables sectors, which are the manufacturing and commercial agricultural sectors. Educated manpower and infrastructure, for example, are prerequisites to manufacturing and commercial agricultural production. PNG has serious shortfalls in these areas but these are not discussed. Auty assumes that *structural changes* and *macroeconomic reforms* epitomised by the *Washington Consensus* would cause economic growth leading to manufacturing and agricultural production. As the words in italics quoted above show, Auty's solution to PNG's resource curse is financial deregulation (such as floating the fixed exchange rate regime inherited from the colonial era), privatisation of government assets and general cost-cutting measures (such as

[10] The Mineral Resources Stabilization Fund (MRSF) was established but this was corporatized into Mineral Resources Development Corporation Limited (MRDC), so the fund no longer exists.

[11] Auty, above n 2, at p.219. PNG did eventually float its exchange rate, curtailed its public spending, relaxed its wage indexation and removed or reduced many import and export tariffs as part of the IMF (International Monetary Fund) loan conditions since 1994, but to date diversification into non-mining tradeables is yet to occur. In fact, these structural policies encouraged more mineral explorations and influx of foreign manufactured goods, especially from Asia. I remember well when Christ Haiveta, then Minister for Finance in the then Chan-Haiveta Government, introduced these 'structural adjustment' policies as conditions of an IMF loan to meet budget shortfalls due partly to the prolonged conflict in Bougainville.

reduction in government spending on infrastructure, education and health, and labour reforms by removing wage indexation). These reforms were, in fact, modestly adopted at the insistence of the World Bank and the IMF in the 1980s but more drastically in the 1990s in the form of *structural adjustment programs* (SAPs). Since then, these structural changes favouring the free market have exacerbated the resource curse in PNG instead of reducing or resolving it, which negates Auty's theory – at least as regards PNG. Today, Papua New Guineans generally believe that they were better off under the colonial administration and, after independence, under the *colonial legacy of a high exchange rate, high public spending and wage indexation* that Auty criticises as being the reason for PNG's failure to diversify into production of non-mining tradeables, than under the current neoliberal regime imposed at the insistence of IFIs and aid donor agencies.

In the case of Zambia, Auty concludes that the government there was weak since it appeased rent-seeking urban groups, relied heavily on foreign borrowings, refused to undergo economic restructuring such as floating the exchange rate, failed to diversify its economy into non-mining tradeables, and implemented state interventionist policies, all of which contributed to the resource curse.[12]

Auty compares the poor performance of Latin American countries, Bolivia and Peru, and the Caribbean nation, Jamaica, with the successful development of Chile, which became the first 'guinea pig' country in the world to experiment with neoliberal development theory with the support of the University of Chicago's Department of Economics. Auty explains this success as follows:

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[12] Id., at pp.237-238.

> Chile's prompt implementation of stabilization and liberalization measures in the mid-1970s contrasts with the reluctance of governments elsewhere, whether military or democratic…. Whatever the reason, an important consequence was that Chile embarked on measures designed to encourage competitiveness while other mineral economies were still extracting rents from their mining sectors to promote inefficient import substitution manufacturing or ill-conceived land reforms.[13]

Second, Auty suggests that because of the longevity of its military regime, Chile has been persistent in its *orthodox reforms*, even after massive setbacks in 1982. By the 1990s, he argues, Chile ought to have been treated as the model for all Latin American economies as well as other mineral and petroleum economies. Chile's industrial progress, he argues, exemplifies a development process that proved that, properly used, a resource-rich developing country can deploy its resources wealth as leverage for modernisation.[14]

At the end of his analysis of the macroeconomic policy performance of the six countries above as proof of the resource curse, Auty concludes:

> The sustainable development of mineral economies lies in successful diversification into competitive non-mining tradeables. The mineral sector should not be regarded as the backbone of the economy; instead it should be viewed as a bonus with which to accelerate economic growth and *healthy structural change*. A pragmatic *orthodox policy*, preferably supported by *effective market-conforming intervention*, can achieve this.[15] (Emphasis added).

II. THE CHILEAN MODEL AND OTHER CONTESTING THEORIES

The University of Chicago's neoliberal theory, which was first tested in Chile, warrants scrutiny within the context of other contesting economic theories. In a reaction against

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[13] Id., p.122. Italics supplied for emphasis.
[14] Id., at p.110, see also at p.123.
[15] Id., at p.258.

Keynesian and underdevelopment economics, both of which called for greater government involvement in the economy, economists at the University of Chicago's Economics Department quite literally assumed a war footing, seeing themselves as "warriors in combat with most of the rest of the profession", according to Gary Becker, the conservative economist and Nobel Prize winner in economics.[16] By treating economics as a 'science,' like physics and chemistry, Frank Knight, one of the founders of the Chicago School of Economics, reveals, they taught students to believe "that each economic theory is 'a sacred feature of the system', not a debatable hypothesis."[17] The "core sacred Chicago teaching was that the economic forces of supply, demand, inflation and unemployment were like the forces of nature, fixed and unchanging."[18] This is to say that 'the free market is a perfect scientific system, one in which individuals acting on their own self-interested desires, create the maximum benefits for all. It follows ineluctably that if something is wrong within a free-market economy – high inflation or soaring unemployment – it has to be because the market is not truly free. There must be some interference, some distortion in the system.'[19]

In fact, treating the supply and demand of the free market as a fixed scientific law that autonomously allocates goods and services to meet individual wants originates in neo-classical economics beginning with David Ricardo who used abstract reasoning in his theory of international trade.[20] Unlike classical political economists who incorporated politics, moral philosophy and sociology into their understanding of political economy,

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[16] Katherine Anderson and Thomas Skinner, 'The Power of Choice: The Life and Times of Milton Friedman', aired on PBS on 29 January 2007, quoted in Naomi Klein, *The Shock Doctrine: The Rise of Disaster Capitalism* (2007) p.49.

[17] Frank H. Knight, 'The Newer Economics and the Control of Economic Activity' (August 1932) 40 (4) *Journal of Political Economy*, pp.455, cited in Klein, id., at p.50.

[18] Ibid.

[19] Klein, above n16., p.51.

[20] Peter Self, *Rolling Back the Market: Economic Dogma & Political Choice* (2000) p.5. See also Frank Stilwell, *Political Economy: The Contest of Economic Ideas* (2002) p.147.

neoclassical economists began to narrow the method of inquiry by using mathematical models to represent individual economic behaviour and the functioning of markets.[21] Neoclassical economists focused on static, short-run equilibrium analysis[22], and assumed that resources were allocated efficiently through prices set by the supply and demand of goods and services of free and rational individuals buying and selling on the free market in their pursuit of individual happiness.[23] Since government intervention distorts market prices and impedes the natural and perfect operation in the chain of supply and demand, it should not be allowed to interfere.[24]

These neoclassical views challenged classical political economic explanations about prices being determined by other things like land, labour and capital, which are the principal factors of production. The neoclassical views held that it was demand that played the crucial role. As Menger puts it, 'the value of goods arises from their relationship to our needs, and it is not inherent in the goods themselves. With changes in these relationships, value arises and disappears.'[25] Classical political economy focuses on *production*, but neoclassical theories focuses on *exchange*. The emphasis shifted from the *factors of production* of the classical era to that of *scarcity* and *relative scarcity* that is supply and demand, relative to unlimited human wants. Neoclassical economists,

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21 Neoclassical economics originated in the 1870s with the works of the English economist William Stanley Jevons (1835-82), *The Theory of Political Economy* (1871); the Austrian economist Carl Menger (1840-1921), *Principles of Economics* (first published 1871, 1976 ed); and the Swish-French economist Leo Walras (1834-1910), *Elements of Pure Economics* (translated and annotated by William Jaffe, 1954). Alfred Marshall (1842-1924) authoritatively synthesised their theories in his *Principles of Economics* (first published 1890).

22 Irma Adelman, *Theories of Economic Growth and Development* (1961) p.vii.

23 Ibid.

24 Jevons, above, n21, (3rd ed. 1888). The utility theory is explained in chapter 3, and exchange theory in chapter 4. Karl Menger, *Principles of Economics* (translated by James Dingwall and Bert F. Hoselitz, 1976); Mathew Forstater, with an introduction by James Rollo, *Little Book of Big Ideas: Economics* (2007) pp.50-51.

25 Menger, id., (1950 ed) p.120.

therefore, firmly believe that 'markets are the most effective as well as the most democratic mode of economic organisation that has yet been developed.'[26]

John Maynard Keynes (1883-1946), a former student of Alfred Marshall (the father of neoclassical economics) challenged this position and argued that neoclassical theory had failed to address real economic problems such as the repeated recessions of the late 19th century and the Great Depression that began in 1929.[27] The assumption that economic recessions and depressions would autonomously recover over time according to the natural cycle of the law of *laissez faire* capitalism and quickly bring economic activity back to equilibrium is not supported by real-life experiences.[28] In real life, if employment falls, then not only do wages drop, but fewer people are earning money, and this leads to fewer people demanding goods and services which, in turn, affects production and the supply of goods and services. So, instead of addressing the issue of unemployment, assuming all other things remaining the same, the issue must be looked at within the context of the whole system. The whole system cannot be adequately dealt with by the self-regulating market without government intervention. Keynes, therefore, argued that the government must manage the *aggregate demand*, that is, *consumption demand*, *investment demand*, *government demand*, and *export demand* in an economy through (1) fiscal policy, (2) monetary policy, (3) trade policy, and (4) income distribution policy to stimulate economic growth and correct market failures.

Keynes explained that by understanding the relationship between *consumer spending* and other forms of spending like *investments*, *government* and *export*, one could understand

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[26] R. Dorfman, *Prices and Markets*, (1967) p.146.

[27] J M Keynes, *A Tract of Monetary Reform* (1924), posted online by Brad DeLong at http://www.j-bradford-delong.net/Econ_Articles/Reviews/monetaryreform.html. <Accessed 01.05.08>.

[28] Id, at pp.v-viii.

that *incomes* are generated by all four types of spending.[29] When *investment spending* drops, it sets in train the *multiplier effect*, affecting other forms of spending, and this brings down consumer demand. The cycle continues affecting one sector after another, eventually resulting in a fall in total income and output by more than the original fall in investment spending. When there is a fall in investment spending, an economy takes quite a while to recover from the fall because it becomes difficult for business confidence to be restored.[30] Therefore, Keynes argued, a government must purposely intervene in the economy to manage the *aggregate demand* by pursuing full employment and social welfare policies in education, health, pension, and public infrastructure.[31]

Keynesian economics informed U.S. President Franklin D. Roosevelt's New Deal in the 1930s and 1940s, brushing aside *laissez-faire* ('hands off') capitalism and the 'trickle down' view of neoclassical economists.[32] Under the New Deal, the U.S. government intervened in the economy to create demand by pursuing full employment and social welfare policies in education, health, pension and social welfare. The U.S. precedent was adopted in the Nordic states, Western Europe, New Zealand, Canada and other industrialised capitalist countries.[33] Today, many 'economists believe that deficit spending on national defence, in preparation for World War II, is what pulled the U.S.

[29] Kit Sims Taylor, 'Human Society and the Global Economy: The Keynesian Revolution', online at http://distance-ed.bcc.ctc.edu/econ100/ksttext/keynes/keynes.htm. <Accessed 01.05.08>.

[30] Ibid.

[31] 'The Great Depressions and the New Deal, 1929-1940s', part of the *United States History, 1877 -: Part II: War, Depression and War, 1914-1945*, online at http://iws.ccccd.edu/kwilkison/Online1302home/20th%20Century/DepressionNewDeal.html. <Accessed 12.11.08>.

[32] 'Keynesian Impact on Public Policy' online at http://cepa.newschool.edu/het/essays/keynes/publicpolicy.htm. <Accessed 12.11.08>.

[33] Goronwy Rees, *The Great Slump* (1970); Simon Clarke, *Keynesianism, Monetarism, and the Crisis of the State* (1988); Robert Lekachman, *The Age of Keynes* (1970).

and other nations out of the Great Depression.'[34] Many economists also believe that because of the success of Keynesian economics during the war, almost all free governments around the world became Keynesian.[35] It was this 'Keynesian Consensus' that the Chicago School of Economics set itself to fight against in order to restore 'free market' neoclassical (orthodox) economics.

In the forefront of this battle was Milton Friedman (1912-2006), who combined specifically selected texts from political liberal theory, and classical and neo-classical economics theory to promote 'market freedoms' and 'individual choice'.[36] Friedman, who has been called the 'guru' of neoliberalism,[37] observed in his influential book *Free to Choose* (co-authored with his wife, Rose) that:

> Economic freedom is an essential requisite for political freedom. By enabling people to cooperate with one another without coercion or central direction, it reduces the area over which political power is exercised. In addition, by dispersing power, the free market provides an offset to whatever concentration of political power may arise. The combination of economic and political power in the same hands is a sure recipe for tyranny.[38]

Friedman's observations were made after interpreting the concept of the 'invisible hand' introduced by Adam Smith as follows:

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34 Steve Kangas, *A Brief Review of Keynesian Theory* posted online at http://www.huppi.com/kangaroo/LiberalFAQ.htm. <Accessed 01.04.08>.

35 Steve Kangas, *Causes of the Great Depression*, posted online at http://www.huppi.com/kangaroo/Causes.htm#keynesianism. <Accessed 01.05.08>.

36 Stilwell, above n 20, at p. 390; Robert W. McChesney, 'Noam Chomsky and the Struggle against Neoliberalism' (1999) *Monthly Review* p.1.

37 McChesney, ibid; Alison M. Phipps and Manuela Gilherme (eds.), *Critical Pedagogy: Political Approaches to Language and Intercultural Communication* (2004) p.13; Robert W. McChesney, 'Global Media and Democracy', dated 14 April 2000, posted online at http://www.ratical.org/co-globalize/ifg041400RM.html. <Accessed 07.05.08>.

38 Milton and Rose Friedman, *Free to Choose* (1980 ed) pp.2-3.

> One set of ideas was embodied in the *Wealth of Nations*, the masterpiece that established the Scotchman Adam Smith as the father of modern economics. It analyzed the way in which a market system could combine the freedom of individuals to pursue their own objectives with the extensive cooperation and collaboration needed in the economic field to produce our food, our clothing, our housing. Adam Smith's key insight was that both parties to an exchange can benefit and that, so long as cooperation is strictly voluntary, no exchange will take place unless both parties do benefit. No external force, no coercion, no violation of freedom is necessary to produce cooperation among individuals all of whom can benefit. That is why, as Adam Smith put it, an individual who 'intends only his own gain' is 'led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interests he frequently promotes that of society more effectually than when he really intends to promote it. I have never known much good by those who affected to trade for the public good.'[39]

While Friedman was concerned about the dangers of concentration of economic and political powers in the same hands, he failed to address the fact that concentration of economic power in the same hands through market freedom can lead to tyranny. At the time of his writing, Friedman likely had in mind tyrannies like the Italian Fascists, the German Nazis and the Soviet Communists. At that time, many critics viewed Keynesian economics to be 'statist and inward-looking', supporting these types of tyrannical rulers, which threatened the individual freedom and free choice that Friedman advocated.[40] However, Friedman failed to deal with corporations that stood to benefit from keeping the government out of the economy and taking over natural monopolies such as electricity, water supply and telecommunications, and opening up protected borders of developing economies to expand their markets and investment opportunities. Meanwhile,

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[39] Id., at pp.1-2.

[40] H. W. Singer, 'Editorial: The Golden Age of the Keynesian Consensus – The Pendulum Swings Back' (1997) 25 (3) *World Development* pp.293-295.

the corporate sector saw that Friedman's views would benefit them, so many of them funded the Chicago School to promote the 'free market' theory.[41]

This thesis argues that corporate funds kept Friedman and his followers from addressing the tyranny of monopoly capitalism, which could cause the same problems as political tyrants.[42] Underdevelopment economists, informed by Keynesian and Marxist theories, advocated workers' rights suppressed by corporate tyrants, while the Chicagoans were advocates of the entrepreneur, 'both claiming that if they got their way, perfection and balance would follow'.[43] Marxism was not a threat to the Chicago School. As Naomi Klein writes, '*The real threat came from the ideas of Keynesians in the United States, the social democrats in Europe and the developmentalists in the Third World. Keynesians were believers in a mixed economy for the manufacture and distribution of consumer products, socialism in education, state ownership of essentials like water services, and all the kinds of laws designed to temper the extremes of capitalism'*.[44]

Friedman and his neoliberal colleagues focused on a narrow strand of classical liberalism, sometimes referred to as *libertarianism* or *Lockean liberalism* (because of its identification with the writings of John Locke and his forebears like Adam Smith, Jeremy Bentham, and John Stuart Mill[45]) to argue that government regulation of the economy must be curtailed to prevent violation of sovereign individual rights to life, liberty and property, since these rights came into existence before any political association.[46] The

[41] See Greg Grandin, *Empire's Workshop: Latin America, the United States, and the Rise of the New Imperialism* (2006).
[42] See Klein, above n16, at p.68.
[43] Id., at p.52.
[44] Id, p.53. Emphasis supplied.
[45] James Stuart Mill, *On Liberty* (People's ed., 1865) p.6.
[46] A useful exposition of libertarianism is provided by the *Stanford Encyclopedia of Philosophy*, which can be found at http://plato.stanford.edu/entries/libertarianism/. <Accessed 06.05.08>. On Lockean

Chicago School also appropriated selective views of classical political economists like Adam Smith who wrote: 'Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring forth his industry and capital into competition with those of any other man, or order of men.'[47] Smith argued that a government must not interfere in *laissez faire* capitalism apart from its three natural duties, which are:

> First, the duty of protecting the society from the violence and invasion of other independent societies; secondly, the duty of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice; and thirdly, the duty of erecting and maintaining certain public works and certain public institutions, which it can never be for the interest of any individual, or small number of individuals, to erect and maintain; because the profit could never repay the expense to any individual or small number of individuals, though it may frequently do much more than repay it to a great society.[48]

By selecting and choosing texts such as this from classical and neoclassical political and economic literature, Milton Friedman and other members of the Chicago School combined liberal political philosophy with the classical political economists' views on *free trade*, *unrestricted competition* and *reduced government intervention* to design a set of economic policies to promote economic growth led by the private sector with minimal government involvement, which was first implemented in Chile in the 1970s.[49] Key

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liberalism, see Ruth W. Grant, *John Locke's Liberalism* (1987); See a review of that book by Patrick Coby, 'John Locke's Liberalism by Ruth W. Grant' (1988) 50 (3) *The Review of Politics*, pp.488-490. Charles T. Sprading, *Liberty and the Great Libertarians: An Anthology on Liberty: A Hand-book of Freedom* (1913) p.20-21. D. F. B. Tucker, *Law, Liberalism and Free Speech* (1985) see esp. ch. 2.

47 Adam Smith, *An Inquiry Into the Nature and Causes of the Wealth of Nations* (first published 1776, edited by Edwin Cannan, 1930) pp.184-85.

48 Smith, ibid.

49 See Klein, above n16; Diana M. Liverman and Silvina Vilas, 'Neoliberalism and the Environment in Latin America' (2006) 31 *Annual Review of Environmental Resources* pp.327-363.

pillars of the neoliberal policies implemented in Chile were: '*privatization, deregulation and cuts to social spending – the free-market trinity*.'[50]

Santiago, Chile's capital, was the seat of the United Nations Commission for Latin America (UNCLA), which, under the leadership of Raul Prebisch in the 1950s and 1960s, espoused a 'radical' brand of development economics that called for full economic sovereignty.[51] The UNCLA economists called for full sovereignty over natural resources that were controlled by transnational corporations (TNCs) from the U.S., Japan and Western Europe. These 'developmentalists' argued that the colonial enterprise and international trade had not been necessarily useful for economic development - as the classical and neoclassical theories might imply. Rather, by changing and gearing the institutional, production and socio-economic structures of a country towards the First World, colonialism had created a rather unique set of structural problems in these countries - namely, export-orientation and unbalanced growth. Third World countries were not 'developed' but 'badly developed' or 'under-developed'. Prebisch and his group thus argued that international trade was only reinforcing this 'under-development' path. With distorted national institutions and economic structures, Third World countries were defenceless against development implied by trade-induced interaction with heavily financed First World monopolistic capitalism. Consequently Third World countries were being dragged into a state of dependency upon the First World, becoming the producers

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50 Klein, above n16, at p.77. Emphasis added.

51 For detailed discussion on this, see Raul Prebisch, *The Economic Development of Latin America and Its Principal Problems* (1950); Jorge Larrain, *Theories of Development: Capitalism, Colonialism, and Dependency (*1989); Charles P. Oman and Ganeshan Wignaraja, *The Postwar Evolution of Development Thinking* (1991); Richard Peet and Elaine Hartwick, *Theories of Development* (1999); Diana Hunt, *Economic Theories of Development: An Analysis of Competing Paradigms*, (1989); Juan Corradi, 'Dependency and Foreign Domination in the Third World' (Spring 1972) 4 *The Review of Radical Economics* pp.1-125; H. W. Singer, 'Dualism Revisited: A New Approach to the Problems of the Dual Society in Developing Countries' (October 1970) 7 *Journal of Development Studies* pp.60-75; Mitchell Seligson, 'The 'Dual Society' Thesis in Latin America: A Re-examination of the Costa Rican Case" (September 1972) LI *Social Forces* pp.91-98.

of raw material for First World manufacturing development - a 'center-periphery' relationship. Prebisch and others thus argued that trade protectionism and import-substitution strategies were necessary if these countries were to enter a self-sustaining development path.[52]

This underdevelopment theory, and its enthusiastic embrace by Latin American countries, threatened the interests of TNCs, particularly those from the U.S. and Great Britain, which faced nationalisation of their operations. To garner support from their home government, 37 American corporations, including Ford Motors, U.S. Steel, DuPont, Standard Oil, Anaconda Copper, International Telephone and Telegraph, United Fruit, and Chase Manhattan Bank, formed the Business Group for Latin America (BGFLA) in the mid-1960s. 'David Rockefeller, whose family had extensive holdings in Latin America going back to the nineteenth century, coordinated the group's activities and served as its liaison with the White House.'[53] The BGFLA and the U.S. government interpreted the 'underdevelopment' theory as a pretext of Communism to lure the Third World countries into its fold. Of course this was not true, but the U.S. government and its corporations used it as propaganda to create fear and legitimise interference in the affairs of Latin America and other developing countries.[54]

In Chile in the 1950s, the U.S. government and its corporations used Albion Patterson, then director of the U.S. International Cooperation Administration (which subsequently

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[52] See generally Hollis B. Chenery, 'The Structuralist Approach to Development Policy' (May 1975) 65 (2) *The American Economic Review* pp.310-316; Sing Chew and Robert Denemark (eds), *The Underdevelopment of Development: Essays in Honour of Andre Gunder Frank* (1996); James D. Cockcroft, Andre Gunder Frank and Dale Johnson (eds), *Dependence and Underdevelopment*, (1972); Andre` Gunder Frank, *Capitalism and Underdevelopment in Latin America: Historical Studies of Chile and Brazil* (1967); Andre` Gunder Frank *Latin America: Underdevelopment or Revolution: Essays on the Development of Underdevelopment and the Immediate Enemy* (1969).

[53] Grandin, above n41, at p.5.

[54] J. W. Smith, *Economic Democracy: The Political Struggle of the 21st Century* (4th ed., 2005) p.116.

became USAID) in Santiago, to design a program of 'intellectual imperialism' in order to counter the influence of Prebisch and the Keynesian and neo-Marxist underdevelopmentalists. The Chicago School, filled with enemies of the Keynesian Consensus, was the ideal institution to serve this (indoctrination) purpose. So, in 1953, Patterson met with Theodore W. Schultz, chairman of the Department of Economics at the University of Chicago, and planned to train Chilean economists to counter the influence of the underdevelopment school. Klein writes of this plan as follows:

> What set the plan apart from other U.S. training programs that sponsored Latin American students, of which there were many, was its unabashedly ideological character. By selecting Chicago to train Chileans – a school where the professors agitated for the near-complete dismantling of government with single-minded focus – the U.S. State Department was firing a shot across the bow in its war against developmentalism, effectively telling the Chileans that the U.S. government had decided what ideas their elite students should and should not learn.[55]

The Patterson Plan set up a student exchange program between the University of Chicago and the Chilean Catholic University, after the initial offer to the prestigious Chilean University was turned down. After its official launch in 1956, the project saw one hundred Chilean students pursue advanced degrees at the University of Chicago between 1957 and 1970. The project was fully funded by U.S. taxpayers and U.S. corporate entities like the Ford Foundation. By 1963, 12 of the 13 staff members in the Economics Department at the Chilean Catholic University were graduates of the Chicago University. Other Chicago graduates filled important positions in government departments. But by the 1960s, the 'Chicago Boys' were not leading their country anywhere. By the time of the 1970 elections, Chile so thoroughly embraced underdevelopment theory that all three

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[55] Klein, above n16, at p.60.

major political parties were in favour of nationalising the country's largest source of revenue: the copper mines then controlled by U.S. mining giants. After Salvador Allende, the left-leaning Popular Unity government candidate won the elections but 'before he was even inaugurated, corporate America declared war on his administration'.[56] Through covert and overt operations by corporate America and the U.S. government, through its Central Intelligence Agency (CIA), the Allende government was overthrown by a military coup led by General Augusto Pinochet on 11 September 1973.[57] During the long dictatorial rule of General Pinochet (1974-1990), the Chicago neoliberal program was imposed. What could not be achieved through intellectual imperialism was achieved through neocolonialism and military dictatorship.[58]

Did the neoliberal experiment cause economic growth in Chile? Grandin records that after massive privatisation, which involved 400 state industries that saw the transfer of public wealth to the private sector, thousands of public workers lost their jobs. Privatisation went so far as to include health care and public pension funds. Drastic legal changes were introduced to deregulate the financial industry, remove import tariffs and restrictions on foreign investment, remove labour regulations, and other reforms to promote open trade and free market capitalism. The results were a 13 percent decline in gross national product (GNP); 28 percent loss in industrial production; collapse of purchasing power by 40 percent of its 1970 level; mounting national business bankruptcies, and a soaring unemployment.[59]

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56 Id, p.64.
57 Grandin, above n41, at p.164.
58 See Andre Gunder Frank, *Economic Genocide in Chile: Monetarist Theory versus Humanity* (1976) pp.41-42.
59 Grandin, above n 41, at p.170.

By 1978, however, the economy rebounded, expanding 32 percent between 1978 and 1981. While salary levels remained 20 percent below what they were a decade earlier, per capita income slowly climbed again. What led this modest improvement, for which the Chicago economists received credit, was not investment in industry or agriculture, which are recommended by the RCT, but speculative finance capital, which flooded into the economy to capitalize on the deregulated financial system.[60] A large part of this inflow comprised private debt, which was $2 billion in 1978, which then climbed to over $14 billion by 1982.

In 1982, Chile's economy crashed despite its strict adherence to the Chicago doctrine. Grandin writes, '*Bankruptcies tripled and unemployment hit 30 percent. Despite his pledge to hold firm, Pinochet devalued the escudo, devastating the poor Chileans who had availed themselves of liberalized credit to borrow in dollars or who held their savings in escudos. The Central Bank lost 45 percent of its reserves, while the private banking system collapsed.*'[61] Klein argues that the 'Enron-style financial houses that the Chicago Boys had freed from all regulation' was the main cause of the collapse.[62] With the hindsight of the 1997 Asian financial meltdown and the 2008 world credit crunch, this argument is strong.

Despite the weaknesses of all the other years that Chile's economy was under the sway of the neoliberal Chicago School, Auty insists that the golden years between 1978 and 1981 serve as a model for other developing countries to follow. Auty selects only the golden years and not the 1982 collapse and its subsequent upheaval. After the speculative

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[60] Klein, above n 16, at p.85.
[61] Grandin, above n 41, at p.171. Emphasis added.
[62] Klein, above n16, at p.85.

financial inflow that caused the spectacular growth had burst, and coupled with plummeting copper prices, the situation was so unstable that General Pinochet was forced to do exactly what the democratically-elected Allende had done – nationalise the privatised companies.[63] Grandin wrote, '*The crisis forced the state, dusting off laws still on the books from the Allende period, to take over nearly 70 percent of the banking system and reimpose controls on finance, industry, prices, and wages.*'[64] But more than that, Chile had never privatised Codelco, its national copper mine company that Allende had nationalised. Coldeco accounted for 85 percent of Chile's export earnings, 'which meant that when the financial bubble burst, the State still had a steady source of funds.'[65] That is how Chile recovered, by relying on one nationalized copper mine company. But the RCT hides or ignores this fact and portrays Chile's recovery after the 1982 crisis as due to its reliance on neoliberal policies persistently maintained by Pinochet's military regime. By presenting such a selective, one-sided and partial story, Klein wrote, 'Chile is still held up by free-market enthusiasts as proof that Friedmanism works.'[66] Hence, the neoliberals and IFIs, which benefited enormously from the dispossession of Chilean wealth through privatisation and financial liberalisation, promote that partial story as a model for all other developing countries to follow.

When commodity prices fell in the 1980s, and when developing countries sought financial assistance from the IFIs, chiefly the International Monetary Fund (IMF) and the World Bank, neoliberal reforms in the form of *structural adjustment programs* (SAPs) were demanded and imposed.[67] Through the SAPs, the Chilean neoliberal experiment

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63 Ibid.
64 Grandin, above n41, at p.171. Emphasis added.
65 Klein, above n16, at p.85. See also Jose Pinera, 'Wealth Through Ownership: Creating Property Rights in Chilean Mining' (Fall 2004) 24 (3) *Cato Journal* p.296.
66 Klein, above n16, at p.85.
67 Richard Peet, *Unholy Trinity: The IMF, World Bank and WTO* (2003).

had spread across Latin America by the late 1980s. By the 1990s the *free-market trinity* had expanded to ten specific policies now termed the *Washington Consensus* as enumerated in Chapter One.[68] The Washington Consensus demands that:

> 'You must attain price stability'. In order to achieve price stability, 'You should maintain fiscal discipline and avoid fiscal deficits', with three corollaries: 'You should forgo subsidies', 'You should privatise public enterprises' and 'You should broaden the tax base'. You must liberalize interest rates and attain total financial liberalizations in a broad sense, including capital account liberalisation; adopt an equilibrium exchange rate; eliminate protection; liberalize foreign direct investment; deregulate the economy; and protect property rights.[69]

The Chilean experiment shows that without political sponsorship and corporate funding, the neoliberals and their *Washington Consensus* agenda would not have become popular. But the Consensus, informed by supply-side economics, monetarism and minimalist government, has expanded because it is favourable to TNCs that seek to secure and exploit natural resources and investment opportunities. By influencing their home governments through corporate-funded policy think-tanks and political lobbying, free market sponsors have utilized politics during the Reagan presidency (1981-1989) in the U.S. and the Thatcher government (1979-1990) in Great Britain to restructure their economies in favour of the corporate elites.[70] In the United Kingdom, the Thatcher government pursued reductions in tax for the rich; manipulation of the money supply to reduce inflation; privatisation of public industry; reduction of trade union power; reduction of government's role in the economy; and encouragement of people to save,

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[68] See John Williamson, 'What Washington Means by Policy Reform' in J. Williamson ed., *Latin American Adjustment: How Much Has Happened?* (1990); John Rapley, *Understanding Development: Theory and Practice in the Third World* (2nd edition, 2002); Jan Joost Teunissen and Age Akkerman (eds.), *Diversity in Development – Reconsidering the Washington Consensus* (2004).

[69] Ariel Buira, 'The Dogmatism of the Washington Consensus' in Teunissen and Akkerman (eds.), ibid, at pp.44-45. The quotation has been slightly edited.

[70] Ibid.

work and buy property.[71] In the U.S., the Reagan Administration pursued four major objectives: reduction of government spending; reduction of the marginal tax rates on income from both labour and capital; reduction in regulations; and reduction of inflation by controlling the growth of money supply, which subsequently became known as 'Reaganomics'.[72] 'These major changes, in turn, were expected to increase savings and investment, increase economic growth, balance the budget, restore healthy financial markets, and reduce inflation and interest rates,' wrote William A. Niskanen.[73] Thatcherism and Reaganomics were soon followed in many countries around the world including 'Rogernomics' in New Zealand[74] and *economic rationalism* in Australia.[75] Cutting costs, encouraging savings and promoting private investments to stimulate economic growth dominated intellectual consciousness during the 1980s-1990s.[76] It was during this neoliberal period of '*small government for the public and big government for big business'* that the RCT emerged.

The foregoing review reveals four important facts. First, there is no such thing as a 'free market', that is, one that is free from government intervention, as the neoliberals and the RCT claim. Political power and economic wealth are enmeshed and intricately connected. But by advocating the removal of government oversight and regulation of corporate economic activities, neoliberals promote corporate interests, which want to use

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71 These policies subsequently became known as 'Thatcherism'. See succinct information on this at http://www.economyprofessor.com/economictheories/thatcherism.php <Accessed 22.08.07>.

72 See http://www.economyprofessor.com/economictheories/reaganomics.php <Accessed 22.08.07>.

73 William A. Niskanen, *Reaganomics*, online at http://www.econlib.org/LIBRARY/Enc/Reaganomics.html <Accessed 22.08.07>.

74 This is referred to Roger Douglas who was appointed Finance Minister in 1984 in the fourth Labour government under Prime Minister David Lange (1942-2005), during whose term neoliberal reform were implemented. For details see Judith Bell, *I See Red: The Shocking Story of a Battle Against the Warehouse* (2006); Colin James, *The Quiet Revolution* (1986); Jane Kelsey, *The New Zealand Experiment: A World Model for Structural Adjustment* (1995).

75 Nan Seuffert, 'Nation as Partnership: Law, 'Race', and Gender in Aoteaora New Zealand's Treaty Settlements' (2005) 39 (3) *Law and Society Review* p.485.

76 See Noam Chomsky, *Profit Over People: Neoliberalism and the Global Order* (1999).

political power only for their benefit to the detriment of the vast majority. Secondly, the RCT is an ideological discourse, which acts as a red herring that serves to divert attention away from corporate exploitation, and the harmful consequences of neocolonialism and imperialism promoted by the industrialised powers for their benefit. Third, the Chilean experiment is hardly an enviable model. The Chilean population suffered brutal murders, massive unemployment and destruction of local businesses as a result of the dictatorial military rule that caused scores of other untold social and economic miseries. Yet, for the resource curse theorists, Chile provides a good model for Latin America and other developing countries, a very hypocritical proposition indeed. Fourth, economic development theories conceived and disseminated in First World institutions such as the RCT are at variance with Third World experiences. Yet notwithstanding the irrelevance of such theories in understanding Third World conditions, and without any proven benefit to a large section of poor people in those countries, they become popular because of the political and corporate sponsors that promote them and the popularity of individual economists and institutions, as the next section below demonstrates in the case of the RCT.

III. ECONOMIC MODELLING AND POPULARITY OF THE RCT

In presenting his RCT, Auty did not apply *econometrics* (economic modeling) to test his hypothesis that natural resource abundance indeed curses resource-rich developing countries by repressing economic growth and generating other socio-political ills. Auty only conjectured that since a general pattern was emerging that showed that resource-rich developing countries tend to perform poorly than resource-poor developing countries in terms of growth it must be the abundance of natural resources that curse the resource-rich

developing countries.[77] Other researchers used mathematical models to confirm Auty's resource curse thesis.

Based on citations in curse literature reviewed to date (2008), the single most influential work on this issue and the first to apply economic modeling to test the RCT is a 1995 study by Jeffrey D. Sachs and Andrew M. Warner.[78] This thesis posits that it was the popularity of Sachs, who then headed the Harvard Institute for Economic Development based at Harvard University, that catapulted the RCT from obscurity to popularity.[79] Sachs, one of the young professors in economics at Harvard and a Keynesian specialising in inflation and recession, rose to fame after he helped to reduce and control Bolivia's inflation, which had soared to 14,000 percent in the 1980s. Sachs was well-versed with Keynes's writings on the connection between hyperinflation and the spread of Fascism in Germany after the First World War, and 'knew just about everything that needed to be known' about inflation, but by his own admission, nothing about development economics.[80] So, when the Bolivian government sought his help to control the country's hyperinflation, Sachs abandoned Keynesianism and adopted the Chicago School's precepts by advising Bolivia to increase the price of oil tenfold and a range of other price deregulations and budget cuts. According to Ricardo Grinspun, an economics professor specialising in Latin America at York University in Toronto, a Keynesian approach to address the hyperinflation would have been to mobilize support and share the burden through a negotiated process involving key stakeholders – government, employees, farmers, unions and so on – so as agree upon income policies like wages, prices and other

[77] Richard M. Auty, *Patterns of Development: Resources, Policy and Economic Growth* (1995) p.19.

[78] Jeffery D. Sachs and Andrew M. Warner, 'Natural Resource Abundance and Economic Growth' (National Bureau of Economic Research Working Paper Series – Working Paper No.5398, Harvard Institute for International Development, Harvard University, 1995).

[79] See Stevens, above n 1.

[80] Jeffrey D. Sachs, *The End of Poverty: Economic Possibilities for Our Time* (2005) pp.90-93.

stabilisation measures.[81] Instead, Sachs recommended a 'shock therapy' of the Chicago neoliberals, which shifted all social costs to the poor and all benefits to the rich.[82] One would ask why a Keynesian would recommend the policies of its archrivals. According to Naomi Klein:

> Although Sachs shared Keynes's belief in the power of economics to fight poverty, he was also a product of Reagan's America, which was, in 1985, in the midst of a Friedman-inspired backlash against all that Keynes represented. Chicago School precepts about the supremacy of the free market had rapidly become the unquestioned orthodoxy in Ivy League economics departments, including Harvard's, and Sachs was definitely not immune. He admired Friedman's faith in markets, his constant insistence on proper monetary management', calling it 'far more accurate than fuzzy structuralist or pseudo-Keyensian arguments one hears a lot in the developing world.'[83]

Although Sachs's prescriptions sent Bolivia's masses into poverty and onto the streets begging for food, his shock therapy worked and hyperinflation was brought down within two years. The media and other commentators interpreted Bolivia's recovery as a stunning free-market success story, the 'most remarkable of modern times', proclaimed *The Economist* magazine.[84] '*'Bolivia's Miracle' gave Sachs immediate star status in powerful financial circles and launched his career as the leading expert on crisis-struck economies, sending him on to Argentina, Peru, Brazil, Ecuador and Venezuela in the coming years*.'[85] In the 1990s Sachs was in charge of the U.S. economic team to Russia that diagnosed the country's problem as arising from lack of 'free enterprise' and recommended the 'wholesale shutdown of Russian industry'.[86]

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81 Based on personal interview cited by Klein, above n18, at p.149.
82 Klein, ibid.
83 Id, at p.144.
84 'Taming the Beast', *The Economist*, 15 November 1986, cited in Klein, id., at p.151.
85 Klein, ibid. Emphasis added.
86 Smith, above n 53, at pp.136-137.

By 1995, when the modeling of the RCT was done, Sachs was already famous as the world's leading expert on crisis-struck economies. Therefore, Sachs and Warner's model which measured the economic performance of 97 developing countries from 1971 to 1989 using the ratio of natural resource exports to GDP (gross domestic product) was, and is, taken as the leading authority on crisis-struck resource-rich developing countries. In their model, Sachs and Warner show that countries with a high ratio of natural resource exports to GDP from the base year (1971) tended to have low growth rates during the subsequent period (1971 to 1989). Even after controlling important variables for economic growth such as initial per capita income, trade policy, government efficiency, and investment rates, the negative relationship held true. 'To be precise, Sachs and Warner estimate that an increase of one standard deviation in natural resource intensity (on average 16% GNP) leads to a reduction of about 1 percent per year in economic growth.'[87] Referring to earlier attempts to understand this negative relationship, and their departure from those studies, Sachs and Warner observe:

> Many previous researchers have noted the failure of resource-led growth in the 1970s and 1980s, though to the best of our knowledge, none has confirmed the adverse effects of resource abundance on growth on the basis of a worldwide, comparative study of growth, as we do in this paper. Important earlier findings of the failures of resource-led development include several outstanding works by Alan Gelb, culminating in Gelb (1988), and several key studies by Auty, most comprehensively in Auty (1990).[88]

After providing an overview of the various explanations proffered to date on the possible causes of the curse from Jean Bodin's (1530-1596) cultural explanation that *easy riches lead to sloth*, to economic and political explanations, Sachs and Warner conclude: '*We*

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[87] Richard Damania and Erwin Bulte, 'Resources for Sale: Corruption, Democracy and the Natural Resource Curse' (Center for International Economic Studies, Discussion Paper No.0220, University of Adelaide, 2003) p.5.

[88] Sachs and Warner, above n78, at p.3.

ask whether the evidence from the past 20 years supports the notion that abundant natural resources depress growth, and find the answer to be "Yes".' (Emphasis added). In other studies, Sachs and Warner insist that 'although support for the curse of natural resources is not bulletproof, it is nevertheless quite strong.'[89]

Other subsequent researchers simply endorse Sachs and Warner's conclusion, although in different terms and based on their own empirical studies. For instance, Giles Atkinson and Kirk Hamilton confirm the RCT 'by demonstrating that [the] main indicator of resource abundance, the share of resource rents in GDP, is negatively correlated with the GDP per capita growth rate.'[90] For Frederick van der Ploeg, it is true that *resource abundance* is a curse, but the effect of this curse on growth is exacerbated in countries where 'the quality of institutions and the rule of law are bad.'[91] Mansoob Murshed's conclusion is similar, but for him it is the *type* of natural resource endowment that affects the institutions and brings about curse on growth and progress.[92] Only *point-source* type of natural resources, which are also called *concentrated* resources (i.e. minerals and petroleum) curse growth, whereas *diffused* resources (i.e. agricultural commodities) do not, or only to a lesser extent as in the case of coca and coffee.[93] Anne D. Boschini, Jan Pettersson and Jesper Roine agree with Ploeg and Murshed by arguing that the *appropriability* of the resource, that is, how easy it is to realize large economic gains

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[89] Sachs and Warner, 'The Curse of Natural Resources' (2001) 45 *European Economic Review* p.828. See also their 'Natural Resource Abundance and Economic Growth' (Cambridge, MA: Centre for International Development & Harvard Institute for Development, November 1997). This paper is available online at http://www.cid.harvard.edu/ciddata/warner_files/natresf5.pdf. <Accessed 09.01.09>.

[90] Giles Atkinson and Kirk Hamilton, 'Savings, Growth and the Resource Curse Hypothesis' (2003) 31 (11) *World Development* p.1793, at p.1804.

[91] Frederick van der Ploeg, 'Challenges and Opportunities for Resource Rich Economies' (Florence: University of Amsterdam, May 2007), available on line at http://www.iue.it/Personal/RickvanderPloeg/resource%20curse%20survey.pdf <Accessed 10.08.07>.

[92] S. Mansoob Murshed, 'When Does Natural Resource Abundance Lead to a Resource Curse?' (Environment Economics Paper Discussion Paper 04-01, London: International Institute for Environmental and Development, 2004).

[93] Id., at p.1.

within a relatively short period of time and the power of control over it, produces the curse effects.[94]

The single most important concern of the RCT is economic growth, which is critical because 'growth is good for the poor.'[95] But according to the RCT: 'If growth is good for the poor, oil and mineral exports are bad for growth – and hence, bad for the poor.'[96] The resource curse theorists adopt this simple proposition to be applicable to all resources-rich developing countries although some add qualifications to exclude developing countries like Botswana and Malaysia.[97]

Why do natural resources, particularly minerals and hydrocarbons, curse developing countries in which they occur? There are many explanations that look at legal, economic, political and socio-cultural causes. In the next chapter, we will review the literature on each of these causes and explanations advanced to date (2008) by orthodox (neoclassical-neoliberal) development theorists.

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94 Anne D. Boschini, Jan Pettersson and Jesper Roine, 'Resource Curse or Not: A Question of Appropriability' (SSE/EFI Working Paper Series in Economics and Finance, No.534, 2005), available online at http://www.ifw-kiel.de/VRCent/DEGIT/paper/degit_11/C011_050.pdf <Accessed 10.08.07>.

95 David Dollar and Aart Kraay, 'Growth is Good for the Poor' (Policy Research Working Paper 2587, Washington DC: The World Bank, April 2001), available online at http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2001/05/11/000094946_01042806383524/additional/106506322_20041117171013.pdf <Accessed 13.09.07>.

96 Michael Ross, *Extractive Sectors and the Poor: An Oxfam America Report* (Washington DC: Oxfam America, October 2001) p.9. Available online at http://www.oxfamamerica.org <Accessed 13.09.07>.

97 Brett Inder, *Economic Growth and Contraction and Their Impact on the Poor* (Working Paper 03/04), online at http://www.buseco.monash.edu.au/depts/ebs/pubs/wpapers/2004/wp3-04.pdf <Accessed 13.09.07>; Richard Ashely, *Growth May Be Good for the Poor, But Decline is Disastrous of the Non-Robustness of the Dollar-Kraay Result* (August 2007) online at http://ashleymac.econ.vt.edu/working_papers/growthgood.pdf <Accessed 13.09.07>; James Thurlow and Peter Wobst, (2006) 15 (4) *Journal of African Economies* pp.603-625; Oxfam, G*rowth With Equity is Good for the Poor* (June 2000) online at http://team.univ-paris1.fr/teamperso/DEA/Cursus/L3/Memoire/Growth_Inequality%20OXFAM.pdf <Accessed 13.09.07>; James E. Foster and Miguel Szekely, *Is Economic Growth Good for the Poor?: Tracking Low Incomes Using General Means* (9 February 2001) online at http://www.adb.org/Poverty/Forum/pdf/Foster.pdf <Accessed 13.09.07>.

IV. CONCLUSION

Among the contesting economic theories (classical, neoclassical, Keynesian, underdevelopment economics and neoliberal), this thesis argues that the RCT is an ideology of neoliberal economics that obfuscates the colonial, imperial and neocolonial roots of exploitation of natural resources in developing countries. The RCT overlooks these political economy causes of exploitation by promoting 'market freedoms' from the standpoint of orthodox economists who erroneously view economics as a 'pure' science and seek to support their views by using econometric models and not historical experience. It is argued that this abstract method of treating concrete historical political and socio-economic events serves to protect and promote the interests of the ruling corporate and political elites and play the role of a red herring to divert attention away from focusing on the real causes such as legal regimes maintained through neocolonialism, various forms of capital flight and monopoly capitalism.

Social, political and economic miseries of Third World countries caused by colonialism and neocolonialism have provided ideal laboratories for ideas conceived in the industrial centres of the Northern economies to be tested under the pretext of helping developing countries to industrialise and prosper. For example, in the case of the Chicago School and the neoliberals, Chile's dictatorial military ruler provided the opportunity to test their free market ideas, while Bolivia's hyperinflation provided Sachs the opportunity to implement his. Since both ideas promoted the owners of finance capital and other corporate and political elites who benefited from these experiments, the corporate media promoted and popularised these men and their ideas as universally applicable and hence the Washington Consensus. Meanwhile, the victims of their ideas are portrayed as victims of the abundance of their natural resources.

Finally, without presenting a balanced view of the important role a government plays in the development trajectories of developing countries, the resource curse theorists have proceeded to blame governments of developing countries for failing to industrialise. By so doing, they have failed to look at the policies of the industrialised countries, which interfere and impede industrialisation efforts in the developing countries as the case of Chile demonstrates above.

CHAPTER THREE

ORTHODOX EXPLANATIONS ON THE CAUSES OF THE RESOURCE CURSE

INTRODUCTION

This chapter examines the orthodox explanations on the causes of the resource curse from a critical political economy standpoint in general and the experience of Papua New Guinea (PNG) in particular. Section I examines the legal causes and explanations; section II the economic causes and explanations; section III the political economy causes and explanations; and section IV the socio-cultural explanations. Section V provides an analytical summary on these causes and explanations with a conclusion in section VI. The purpose of the chapter is to examine which of the orthodox explanations and causes of the resource curse are relevant to the experience of PNG and also provide a critique from the standpoint of underdevelopment economics examined in chapter four.

I. LEGAL CAUSES AND EXPLANATIONS

Among orthodox literature on the resource curse thesis (RCT) reviewed to date (2008), two legal explanations based on hypothetical rather than empirical studies relevant to the experience of PNG have been advanced since 2006. One segment of the legal explanations stem from the neoliberal economic model of *principal-agent theory* while the other segment is based on *international political economy* of law.[1] Both segments, however, focus on the issue of ownership of minerals and hydrocarbon resources, and how different ownership regimes might cause the resource curse. The first segment originates from the work of Pauline Jones Luong and Erika Weinthal who focus on

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[1] On *principal-agent* theory, read Michael A. Peters, *Poststructuralism, Marxism and Neoliberalism: Between Theory and Politics* (2001), and the articles in Nicolai J. Foss (ed), *The Theory of the Firm: Critical Perspectives on Business and Management* (2000).

ownership structure and *control* over the extraction of mining and petroleum resources while the second segment is advanced by Leif Wenar who emphasises the sanctity of, and the need to, respect *traditional property rights*.[2]

Luong and Weinthal's proposition is that the type of legal structure on ownership and control of natural resource developments a developing country adopts cause the resource curse. In their hypothesis, legal ownership and control regimes determine the strength or weaknesses of institutions, which lead to negative or positive political and economic outcomes in developing countries.[3] They point out that most of the researchers on the RCT have failed to study and analyse the economic effect of *state ownership* of natural resources compared with *private ownership* by customary landowners and foreign corporations.[4] Luong and Weinthal focus on four ownership regimes, which are:

- *State ownership with control*. The state owns the rights to develop mineral deposits and holds the majority of shares (51% +) in production, refining and/or export facilities. Foreign involvement in the mineral sector is limited either to participating in contracts that restrict their managerial and operational control, such as carried interest or joint ventures, or to operating as service subcontractors.
- *State ownership without control*. The state owns the rights to develop mineral deposits and holds the majority of shares (51% +) in production, refining, and/or export facilities. Foreign investors are allowed to participate through more permissive contracts, such as production-sharing agreements (PSAs), which grant them significant managerial and operational control.

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2 Leif Wenar, 'Property Rights and the Resource Curse' (Winter 2008) 36 (1) *Philosophy and Public Affairs* pp.2-32.

3 Pauline Jones Luong and Erika Weinthal, 'Rethinking the Resource Curse: Ownership Structure, Institutional Capacity, and Domestic Constraints' (2006) 9 *Annual Review of Political Science* pp.241-263.

4 Based on my research of the available resource curse literate to date (2008), this assertion is correct.

- *Private domestic ownership*. Private domestic companies own the rights to develop mineral deposits and hold the majority of shares (51% +) in production, refining, and/or export facilities.
- *Private foreign ownership*. Private foreign companies own the rights to develop mineral deposits and hold the majority of shares (51% +) in production, refining, and/or export facilities.[5]

The authors find that *state ownership with control* of mineral reserves fosters business-state relations that are both blurred and symmetrical because there is no clearly identifiable principal or agent between the main actors – state elites and bureaucrats. In most developing countries, such as Venezuela, Mexico, Indonesia and Nigeria, petroleum resources are managed through state oil companies. The close ties between state elites and bureaucrats who are assigned to run the national oil companies have become a 'state within a state' such that managerial elites use their privileged positions to hide capital and squander company revenues on unprofitable projects. Insofar as the power between state elites and bureaucrats is concerned, it is relative and symmetrical because both have direct access to the proceeds from mineral exploitation, and each has exclusive access to information about the income as well as the misdeeds of the other – a situation that is described as 'mutual hostage-taking'.[6] Consequently, this form of business-state relations, in turn, promotes incentives for creating weak fiscal and regulatory institutions because both state elites and bureaucrats want greater discretionary power, and thus prefer institutions that are unlikely to constrain their behaviour in any meaningful or predictable way. 'Their interests thus converge toward the same outcome. This

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[5] Luong and Weinthal, above n3, at pp.244-245.

[6] For general reading on mutual hostage-taking see Minwoo Yin, 'Implications of Global Terrorist Hostage-taking and Kidnapping' (Summer 2007) Vol. XIX, No.2 *The Korean Journal of Defense Analysis* pp.135-165. Ian K. Steel, 'Hostage-taking 1754: Virginians versus Canadians' (2005) 16 (1) *Journal of the Canadian Historical Association* pp.49-73.

encourages a form of implicit bargaining whereby each side tacitly agrees to either (a) undermine existing institutions that might pose a threat to their discretionary authority, for example, by increasing transparency and accountability, or (b) maintain the status quo, and thus neglect institution building altogether.'[7]

Under *private domestic ownership*, business-state relations are both clear and symmetrical. The boundary between the main actors – state elites and domestic owners – is clear because there is a clearly identifiable principal, the managerial structure is clearly defined, there are objective criteria for evaluating managerial performance, and agents do not conflate administrative tasks with political goals. This clarity restrains misuse and abuse of company assets and cause careful investment in productive projects. After all, management of the private company would be interested in efficiency so as to minimize costs and maximize profits and market capitalization, and the expansion of market share. 'Domestic owners possess the rights to revenue from mineral exploitation, and thus are a critical source of tax revenue for the state. State elites possess the authority to revoke property rights and reduce revenue streams by demanding excessive taxation. In short, they need each other not just to survive but to thrive.'[8]

In the case of *state ownership without control* and *private foreign ownership*, there is a clear boundary between the main actors – state elites and foreign investors - because there is an identifiable principal and agent and the control structure is well defined. However, in contrast to the first two types of ownership structure, the relative power between the two main actors in both cases is asymmetrical and dynamic. '*Because the relative power between state elites and foreign investors is asymmetrical and their*

7 Luong and Weinthal, above n3, at p.248.
8 Ibid.

interests diverge, institutional outcomes are more likely to be imposed by the more powerful set of actors.'[9]

Therefore, Luong and Weinthal conclude that *private domestic ownership* is the best form of ownership structure for resource-rich developing countries to avoid the resource curse. Compared with private foreign ownership, private domestic ownership has the potential to promote the local economy by strengthening domestic institutions. The reason is that foreign investors are narrowly focused and concentrated in the extractive sector relying on external suppliers and producing for the export market, and reinvest its profits abroad, whereas a domestic corporation relies on domestic suppliers, produces for the local market as well, reinvests its profits locally, and is generally interested in a broad-based economy with wider linkages.[10]

Luong and Weinthal conclude that '*private domestic ownership offers an alternative path out of the resource curse because it creates an incentive for both state and societal actors to bargain over and eventually establish the formal rules of the game*.'[11] Having come to this conclusion, the authors then pose:

> *If private domestic ownership offers a way for mineral-rich states to escape the alleged curse of their wealth, why has this form of ownership structure been so rare for the past century?* Conversely, why did private foreign ownership predominate during the first half of the twentieth century, and why did state ownership with and without foreign control predominate during the second half?[12]

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[9] Id., at 250. Emphasis added.
[10] Ibid.
[11] Id., at 254. Emphasis added.
[12] Ibid. Emphasis added.

They then answer: '*Given the temporal trends in the data…the most obvious conclusion might be that this variation is due to international factors – namely, the structure of the international oil market and policy convergence*.'[13] In the case of PNG, as will be see in Chapter Ten, it is not the international oil market and policy convergence, but a colonial legal regime inherited by the PNG nation-state upon independence from Australia in 1975 that explains why ownership is vested in the State.

Leif Wenar advances the second leg of the legal explanation.[14] The gist of Wenar's thesis is that the resource curse occurs as a result of stealing the traditional landowners' natural resource wealth by corrupt and repressive regimes who sell them to international corporations. In his words: '*The natural resources of a country belong…to its people. The blessing of resources turns into a curse when tyrants and insurgents are allowed to sell off a country's resources while crushing popular resistance, and to use the proceeds in ways that make the people worse off*.'[15] He argues that because property rights of indigenous people in resource-rich developing countries have not been enforced or in some cases recognized, this failure has resulted in the resource curse.

Wenar's argument is premised on international law - customary international law and treaty law such as the *International Covenant on Civil and Political Rights* and the *International Covenant on Economic, Social, and Cultural Rights* - as well as common law, principles of equity and contract law. Wenar argues that international law firmly establishes that the resources of a country belong to the people of that country,[16] 'and no

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[13] Id., at pp.254-55.

[14] Leif Wenar is a Professor at the School of Law at Kings College, London. Wenar's explanations are found in his article above, n2.

[15] Id., at p.8. Emphasis added.

[16] Ibid.

one may sell off this property without some sort of authorization.'[17] That being so, Wenar argues, the customary rule in the system of international trade gets the answer wrong in espousing that the power lies in the entity which has monopoly over the licit use of force, which is the State. Whereas there is ample evidence that the State does not protect rights, and worse, arrogates rights to itself that have traditionally resided in traditional owners under customary rather than state law, international law only recognizes the legal personality of the State. And liberal democratic theory assumes that the State operates benignly under social contract with its citizens. In many States no such contract is evident and the State's imperium and dominium have been acquired through violence.[18] As he puts it:

> In current international practice all that is necessary for a group to acquire the legal right to sell of a territory's resources is the power to inflict violence on the territory's people. Whoever can maintain coercive control over a country's population…is recognized internationally as legally authorized to sell off that country's resources. According to this customary rule, might makes right: specifically, might vests the legal right to transfer property.[19]

Wenar points out that this rule offends the most basic principle of the market: that stolen property does not confer good title. He provides an example of robbers who use *might* to overpower security guards of a warehouse and loot the shop of its contents and then sell them freely on the market. Since they have used *might*, it must be *right*. But that is not

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[17] Id., at p.11.

[18] 'Imperium' means the area or region that a state exercises dominion over, and also speaks of the supreme authority or absolute dominion of such a nation state. 'Dominium' refers to the plenary right which the state as owner has over his property to use as it deems proper, without accountability to any one: *The Free Dictionary* online at http://legal-dictionary.thefreedictionary.com/Plenum+dominium. <Accessed 15.12.08>). For historical origin and development of these terms, see Richard Tuck, *Natural Rights Theories: Their Origin and Development* (1979). See also Ugo Mattei, *Basic Principles of Property Law: A Comparative Legal and Economic Introduction* (2000).

[19] Wenar, above n2, at p.11.

the rule in commerce. Likewise, it should not be in natural resources.[20] Wenar argues that this anti-market practice of 'might makes right' rule is a legacy of colonialism and imperialism under a Westphalian world order, which is not justifiable in today's globalized world order.[21]

In the view of this thesis, the legal explanation is the most important reason for PNG's resource curse or underdevelopment. Therefore, Chapters Ten and Eleven are dedicated to examining the mining and petroleum legal regimes in PNG and how they operate.

II. ECONOMIC CAUSES AND EXPLANATIONS

The economic explanations generally comprise some of those that have already been identified by Auty in Chapter Two, including (1) 'Dutch disease', (2) crowding out effect, (3) linkages failure, (4) long term decline in the terms of trade; and (5) revenue volatility. These five economic explanations predate the introduction of the RCT. The first two are related and form the main economic explanations in orthodox economics literature. The last three form the main economic explanations in *structuralist* theory, which this thesis regards as forming a part of underdevelopment economics; we will examine them in Chapter Five. Let us deal with the first two here.

A. 'Dutch Disease'

The 'Dutch disease' is a separate thesis from the RCT, but since it is generally treated as synonymous and one of the main 'transmission channels' of the RCT, we must take it as

[20] Id., at p.12.
[21] Id., at pp.12-13.

that for now.[22] And, as with the RCT, the 'Dutch disease' thesis has a specific date and origin referring to a specific economic phenomenon before it became a term of general use. According to Max Corden, the term was first used in the 26 November 1977 issue of *The Economist*.[23] It was used to describe the Dutch economic experience where the manufacturing sector declined and suffered general inflation as a result of the booming natural gas sector, which commenced production in 1959.[24] With rising gas exports Holland's exchange rate appreciated against the US dollar and pushed wages up faster than productivity gain in the non-gas sectors of the economy. 'Thus, Holland's competitiveness in its other exports, especially manufacturing, was reduced while its demand for domestic non-tradeable goods rose, giving rise to inflation and declining savings in investment.'[25] Analogous situations later occurred in Australia, the United States and elsewhere, all of which came to be called the 'Dutch disease'.[26]

The Dutch experience was related to the general economic impact of the rise in oil prices in the 1970s. Some commentators argue that there were three major consequences of the oil price increases: 'It led to a series of shocks in the economies of the industrial countries. It reduced further the slow pace of growth in the non-OPEC LDCs [least developing countries], and it distorted the sectoral growth in OPEC itself.'[27] The oil price rise not only caused significant increases in national wealth in oil-exporting economies but also caused similar windfalls to occur in economies that enjoyed major

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[22] Graham A. Davis, 'Learning to Love the Dutch Disease: Evidence from Mineral Economies' (1995) 23 (10) *World Development*, p.1765, at p.1768.

[23] W. Max Corden, 'Booming Sector and Dutch Disease Economics: Survey and Consolidation' (1984) 36 (3) *Oxford Economic Papers*, p.359.

[24] Ibid.

[25] Tan Tat Wai, 'Management of Resource-Based Growth in Different Factor Endowment Conditions' in Miguel Urrutia and Yukawa (eds), *Economic Development Policies in Resource-Rich Countries* (1988) p.112.

[26] Ibid.

[27] Manoucher Parvin and Hashem Dezhbakhsh, 'Trade, Technology Transfer, and Hyper-Dutch Disease in OPEC: Theory and Evidence' (1988) 20 (4) *International Journal of Middle East Studies*, p.469.

resource discoveries.[28] That was the experience of the Dutch who enjoyed windfall gains from gas production in the Groningen fields.[29]

The resource curse theorists adopt the Dutch experience to posit that wealth increases following higher oil prices or resource discoveries has a systemic impact on the sectoral allocation of resources. Booming demand, caused by resource wealth, leads to a shift of an economy's productive resources from tradeable-goods sectors to non-tradeable goods sectors.[30] The Dutch experience of this shift from the tradeables to the non-tradeables was first explained using an econometric model developed by Corden and Neary in 1982.[31] Using Corden and Neary's theory, resource curse theorists explain that the booming natural resource sector pulls factors of production (especially labour and capital) from what Sweder van Wijnbergen called *learning-by-doing* (LBD) sectors, which are the agricultural and industrial sectors.[32] As Sachs and Warner elaborate:

> The greater the natural resources endowment, the higher the demand for non-tradeable goods, and consequently, the smaller will be the allocation of labour and capital to the manufacturing [and agricultural] sector. Therefore, when natural resources are abundant, tradeable production is concentrated in natural resources rather than manufacturing, and capital and labour that otherwise might be employed in manufacturing are pulled into the non-traded goods sector. As a corollary, when an economy experiences a resource boom (either a terms-of-trade improvement, or a resource discovery), the manufacturing sector tends to shrink and the non-traded goods sector tends to expand. The shrinkage of the

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28 Michael Bruno and Jeffery Sachs, 'Energy and Resource Allocation: A Dynamic Model of the 'Dutch Disease',' (1982) *Review of Economic Studies*, p.845.

29 Jeroen M. J. Kremers, 'The Dutch Disease in the Netherlands', in J. Peter Neary and Sweder van Wijnbergen (eds), *Natural Resources and the Macroeconomy* (1986) pp.96-136.

30 Sweder van Wijnbergen, 'Optimal Capital Accumulation and the Allocation of Investment Between Traded and Non-Traded Sectors in Oil-producing Countries' (1985) 87 (1) *The Scandinavian Journal of Economics* p.89.

31 W. Max Corden and J. Peter Neary, 'Booming Sector and De-Industrialisation in a Small Open Economy' (1982) 92 (368) *The Economic Journal* pp.825-848.

32 Sweder van Wijnbergen, 'The 'Dutch Disease': A Disease After All?' (1984) 94 *Economic Journal* pp41-55; See also Egil Matsen and Ragnar Torvik, 'Optimal Dutch Disease' (2005) 78 *Journal of Development Economics* pp.494-515, at p495.

> manufacturing sector is dubbed the "disease", though there is nothing *harmful* about the decline in manufacturing if neoclassical, competitive conditions prevail in the economy.[33]

Corden and Neary describe this effect as *de-industrialization*, and one can extend this to *de-agriculturalization* to include the agricultural sector.[34]

Many empirical studies conducted by economists demonstrate the occurrence of the Dutch disease in resource-abundant underdeveloped countries. For instance, a 1988 study by Allan Gelb[35] and others on the effective management of resource revenue in six oil-exporting countries - Algeria, Ecuador, Indonesia, Nigeria, Trinidad and Tobago, and Venezuela - reveals that:

- there was insufficient savings, especially during the oil booms between 1974-78 and 1979-81;
- there were unsustainable consumption and investment patterns during booms;
- the non-mining tradeable sectors – agriculture and manufacturing – were neglected during booms;
- adjustments to post-boom downswing was tardy; and
- paradoxically, some countries even built up a sizeable debt during the booms by using their oil revenue as collaterals for foreign loans. When the oil prices fell, these countries faced harsh adjustments.

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33 Jeffery D. Sachs and Andrew M. Warner, 'Natural Resource Abundance and Economic Growth' (National Bureau of Economic Research Working Paper Series – Working Paper No.5398, Harvard Institute for International Development, Harvard University, 1995) at p6.

34 Corden and Neary, above n31, at p.830.

35 Alan Gelb, *Oil Windfall: Blessing or Curse?* (1988).

Gelb's study confirms earlier studies on the issue of revenue allocation between consumption and capital accumulation in oil-producing countries. For instance, Wijnbergen of the World Bank found in 1985 that '[m]ost oil-exporting countries have run into problems in maintaining or developing nonoil traded goods sector because higher oil revenues lead to a high real exchange rate, thereby pulling resources into the nontraded sector…'[36] Problems faced by the oil-exporting countries also resemble the mineral exporting countries in Auty's study above. Supporting Gelb's findings, Auty observes that his studies reinforces the RCT by revealing a tendency for the governments of 'mineral economies' to depend heavily on the mineral sector and neglect manufacturing or the agricultural sector.[37]

However, Gelb, Auty, and many others also note that some resource-abundant countries like Botswana, Chile, Malaysia, Indonesia,[38] Oman and Thailand among the developing countries, and among the developed countries, Norway, Australia, Canada, Ireland, New Zealand and the United States have escaped the curse.[39] This leads Matsen and Torvik to question 'why some countries have escaped the resource curse while others have not.'[40] By extending the traditional 'Dutch disease' model, Matsen and Torvik developed a model to examine the savings rates of 21 resource-rich countries between 1972 and 2000 and argue that 'those with the highest (resource wealth adjusted) savings rate have

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[36] Wijnbergen, above n30, at p.89.

[37] Richard M. Auty, *Sustaining Development in Mineral Economies: The Resource Curse Thesis* (1993) p.241.

[38] On Indonesia's industrial policy, see Hal Hill, 'Indonesia's Industrial Policy and Performance: 'Orthodoxy' Vindicated' (1996) 45 (1) *Economic Development and Cultural Change* pp.147-174; Thorvaldur Gylfason, 'Natural Resources, Education and Economic Development' (2001) 45 *European Economic Review* p.847.

[39] Halvor Mehlum, Karl Moene and Ragnar Torvik, 'Institutions and Resource Curse' (2006) 116 *The Economic Journal* pp.1-20.

[40] Egil Matsen and Ragnar Torvik, 'Optimal Dutch Disease' (2005) 78 *Journal of Development Economics* p.494, at p.510.

generally managed to escape the resource curse.'[41] While the traditional 'Dutch disease' model emphasizes exogenous factors, Matsen and Torvik's extended model focuses on endogenous factors, namely, prudent management and savings. Their conclusion is that savings can avoid the Dutch disease, which would lead to preventing the curse.

Hence, lack of savings, heavy dependence on resource revenue and expending them on consumption in the non-tradeable goods sector, diversion of labour and capital from agriculture and manufacturing sectors to the booming sector, and higher prices caused by higher wages in the resource sector, with its resultant inflation, all combine to cause the Dutch disease, which consequently affects growth and cause the resource curse.

B. Crowding Out Effects

This theory is related to the Dutch disease. It describes the situation where large oil, gas and mineral projects, compared to the rest of the economy, effectively stake first claim on scare resources, like skilled labour, at the expense of other sectors of the economy. Paul Stevens explains that this issue is important 'in smaller countries when the size of the investment project is large or where there are strong regional dimensions to an economy and the project is focused in one region. In particular, the concept is potentially very important in the transition economies where the process of transition has effectively destroyed the old productive base and a new and private tradable sector is struggling to emerge.'[42] But Steven notes that little work has been done in this area particularly with respect to oil, gas and mineral projects.

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[41] Id., at p.496.
[42] Paul Stevens, 'Resource Impact – Curse or Blessing?: A literature Survey' (London: Centre for Energy, Petroleum and Mineral Law and Policy, University of Dundee, March 2003) at p.13.

Based on my personal experience during the boom years of the late 1980s and 1990s, when mineral and hydrocarbon exploration and production intensified in PNG, the Dutch disease and crowding out effect were obvious. Government employees like school teachers, health workers and technical skilled workers were lured to the booming resources sector. Agriculture was abandoned or neglected. Even many high school and college students left school to seek employment and 'big' and 'quick' money. However, I fail to understand how that would curse a country. In fact, the opposite is true. Higher wages paid by the booming resources sector meant higher income, which led to increased savings and increased tax revenue for the state as well. Many who left school early or low-paid government jobs to work in the mineral and hydrocarbon industries have set up small businesses during their field breaks. Some, after gaining sufficient training and skills, migrated to work in the booming Australian resources industry, and they are now remitting strong dollar to PNG, boosting the country's foreign reserves. Had they remained in the low-paid agricultural sector or government jobs or manufacturing sector, many would not be better off as they are now. Some would still be in school hoping to get low-paid white-collar jobs instead of the money they are making today.

On this basis, it is my contention that the Dutch disease is wrongly applied as being an important explanation for the curse in developing countries like PNG. Many resource-rich but poor countries like PNG are not industrial-based economies, or commercial agricultural-based economies. Many resource-rich but poor countries are simply natural resource-based economies, which Auty correctly identified as 'mineral economies'. In mineral and petroleum economies, while the government is dependent on mineral and

petroleum rents, most people are simply dependent on the subsistence economy, so these countries should be seen as subsistence-based economies as well.

How is it, then, that economic theorists take a big leap to connect and compare an advanced industrial economy like Holland with a predominantly subsistence-based economy like PNG? The truth is that in many countries like PNG labour is leaving subsistence agriculture, not commercial agriculture. Labour is leaving bureaucracy, not industry. If labour is leaving government, then it is good because it is down-sizing government and cutting public expenditure as demanded by neoliberal economic wisdom. For these reasons, this thesis contends that the Dutch disease and crowding out explanations of orthodox economics are irrelevant and inappropriate to understand what they call the resource curse in PNG and other similar developing countries.

III. POLITICAL ECONOMY CAUSES AND EXPLANATIONS

Before the formal introduction of the RCT, several theories have been developed to explain the role and impact of politics and governments in resource mis/management and economic growth.[43] Many of these theories are now used in the resource curse discourse to explain the occurrence of the curse. Ross synthesizes these theories into three groups:

- cognitive theories, which blame policy failures on the shortsightedness of state actors;

[43] For examples, Robert H. Bates, 'Macropolitical Economy in the Field of Development' in James E. Alt and Kenneth A. Shepsle (eds), *Perspectives on Positive Political Economy* (1990); Robert H. Bates (ed), *Toward A Political Economy of Development: A Rational Choice Perspective* (1988); Merilee S. Grindle, 'The New Political Economy: Positive Economics and Negative Politics' in Gerald Meier (ed), *Politics and Policymaking in Developing Countries* (1991); and Thrainn Eggertsson, 'The Old Theory of Economic Policy and the New Institutionalism' (1997) 8 *World Development* p.25.

- societal theories, which examines the influence of privileged classes, sectors, client networks, or interest groups; and
- statist theories, which faults a state's institutional strength or weakness – its ability to extract and deploy resources, enforce property rights, resist the demands of interest groups and rent seekers.[44]

Recently, Robinson, Torvik and Verdier examined four new (although in some ways related to the old) political factors to argue that it is the *political incentives* that resource endowments generate that are key to understanding whether or not there is a curse. The four incentives are:

- the political tendency to over-extract natural resources relative to the efficient extraction path because they discount the future too much, a point which Auty raised above;
- efficiency of the extraction path caused by resource booms;
- resources boom raises the value of being in power and by providing politicians with more resources which they can use to influence the outcome of elections, causing increase resource misallocation in the rest of the economy; and
- the overall impact of resource booms on the economy which depends critically on institutions since institutions determine the extent to which political incentives map into policy outcomes.[45]

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[44] Michael L. Ross, 'The Political Economy of the Resource Curse' (1999) 51.2 *World Politics* p.297, at p.308.

[45] James A. Robinson, Ragnar Torvik and Verdier, 'Political Foundations of the Resource Curse' (2006) 79 *Journal of Development Economics* p.447.

Here, we will examine these explanations under four general heading: (1) trade and industrial policy explanations, (2) corruption and rent-seeking theories, (3) institutional explanations, and (4) other political economy explanations. We will examine the cognitive theory as part of the socio-cultural explanations in Section IV.

A. Trade and Industrial Policy Explanations

Orthodox development theorists compare the trade and industrial policies of resource-rich Latin America and the resource-poor but rapidly industrialising countries of East Asia, particularly Korea, Taiwan and Singapore as discussed in Chapter Two. Based on what Auty calls 'autarkic' policies and what Ross calls 'societal theories', the failure of Latin American economic growth is attributed to *statist* approach to development using economic planning, import-substitution industrialization (ISI), price controls, credit rationing, state-owned enterprises, and government control of agricultural marketing.[46] They argue that such policies are *growth-impeding policies* which resource booms enhance political leverage of non-state actors to resist market-friendly neoliberal reforms.[47] Latin American countries followed ISI, whereas South Korea, Taiwan and Singapore followed export-promoting industrialization (EPI).[48] In Latin America, manufacturers and workers who enjoyed government subsidy pressured their governments against dropping the subsidies even in times of resource booms, which

[46] Nicolas van der Walle, 'Privatization in Developing Countries: A Review of the Issues' (1989) 17 (5) *World Development* pp.601-16; Michael Lofchie, 'The New Political Economy of Africa' in David E. Apter and Carl G. Rosberg (eds), *Political Development and the New Realism in Sub-Saharan Africa* (1994); Tony Killick, 'A Reaction Too Far: Economic Theory and the Role of the State in Developing Countries' (Development Policy Studies, Overseas Development Institute, London, 1989); John Waterbury, 'The Long Gestation and the Brief Triumph of Import-Substituting Industrialization' (1999) 27 (2) *World Development* pp.323-341.

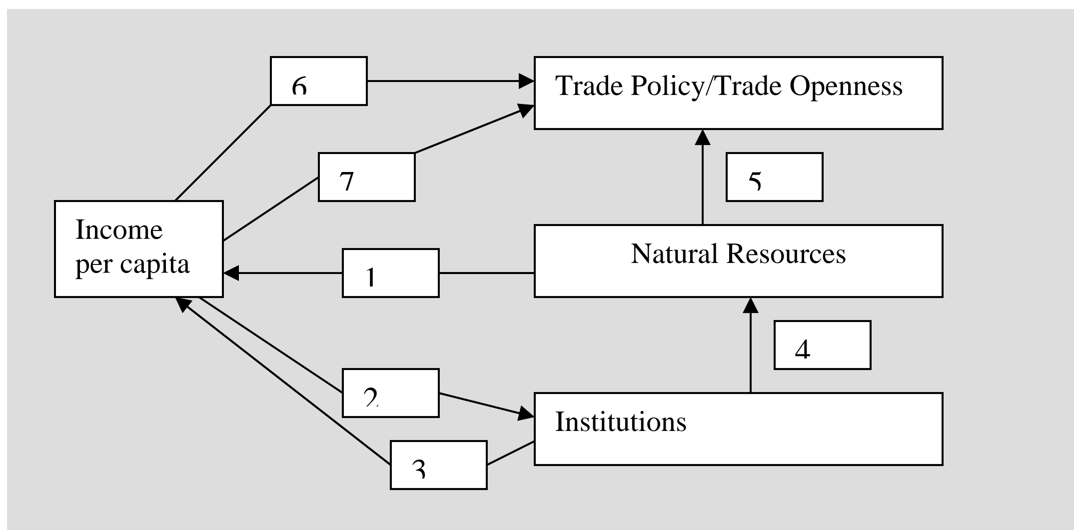
[47] See Miguel Urrutia, 'The Politics of Economic Development Policies in Resource-Rich Countries' in Urrutia and Yukawa (eds), above n25, pp154-165.

[48] Richard M. Auty, *Patterns of Development: Resources, Policy and Economic Growth* (1995) pp.20-21.

favored them. On the other hand, the Asian countries were less dependent on subsidy, and therefore they easily propelled forward with export promotion.[49]

A 2007 IMF study supports this 'free trade', 'export promotion' policy by conjecturing that 'it is not unreasonable to conjecture that a trade policy aimed at more exposure to foreign competition and transfer technology, managerial skills, and know-how from abroad might turn the natural resource curse into a blessing as well.'[50] The implicit assumption in this conjecture is that resource abundance is a curse where there is no open trade policy allowing for international competition. The IMF tested its open trade theory using the following model to assess the direct and indirect effect of natural resources on income per capita:

Figure 3.1



Source: IMF: Direct and Indirect Effects of Natural Resources on Income Per Capita.

According to the IMF study, **Figure 3.1** indicates the various direct and indirect ways by which resource dependence can make a country poor. **Arrow 1** represents the open

49 Ibid.

50 Rabah Arezki and Frederick van der Ploeg, 'Can the Natural Resource Curse be Turned Into a Blessing? The Role of Trade Policies and Institutions' (IMF Working Paper No. WP/07/55, Washington D.C., March 2007) at p.8.

invitation of natural resources for rapacious rent-seeking, which culminates in lowering the income per capita. **Arrows 3** and **4** show that natural resources worsen the adverse impact of bad institutions on the income per capita. **Arrows 5** and **7** represent the argument that the appreciation of the real exchange rate and the decline of the non-resource exposed sectors may induce a lobby for more restrictive trade policies (import substitution, subsidies for pet manufacturing companies, etc.) and in this way lower per capita income. 'Of course...trade policies/trade openness and the quality of institutions also have a direct effect on income per capita (**Arrows 7** and **3**). However, income per capita might also affect trade openness and institutional quality (**Arrows 6** and **2**) and therefore it is important to look for good instruments (including natural resource dependence) to correct for endogenous nature of these explanatory variables.'[51] The IMF study then concludes, among others, that:

- Using income per capita-type regressions and instrumenting for institutional quality and openness, there is direct evidence of negative effect of natural resource exports on income per capita, even after controlling for geography, openness and institutional quality.
- '*We do find that trade policies directed toward more openness can make the resource curse less severe and may even turn it into a blessing… Furthermore, we find that this resource curse is attenuated if countries pursue more liberal trade policies*.' (Emphasis added).

- 'Bad policies are highly correlated with bad fiscal policies. Resource booms may make it easier to boost public sector employment and investment and subsidies

[51] Id, at p.16.

geared towards import substitution in order to win votes and satisfy befriended interest groups. This undoubtedly harms economic performance.'[52]

Ross criticises the trade and industrial policy explanations on three grounds. First, the authors who compare South Korea, Taiwan, Mexico, Colombia and Brazil fail to take into account many differing factors that influence their development trajectories beyond their natural resource endowment.[53] I agree. Critical political economy history of Latin America demonstrates that foreign corporations, the involvement of international development agencies and financial institutions like the IMF, local elites and the United State's foreign policy towards the region have a lot to explain for the curse of the region's resource abundance than these hypothetical reasons the IMF and the curse theorists provide.[54]

Secondly, trade policy arguments are in favour of trade liberalization which would allow foreign capital to have uninhibited access to Third World natural resources. That is the

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52 Id, at pp.25-26.

53 Ross, above n44, at p.310.

54 There is a dearth of material on this, but I only cite a few. Chalmers Johnson, *The Sorrows of Empire: Militarism, Secrecy, and the End of the Republic* (2004); Clara Nieto, *Masters of War: Latin America and U.S. Aggression* (2003); Michel Chossudovsky, *The Globalization of Poverty and the New World Order* (2nd ed., 2003); Al Franken, *Lies and the Lying Lies Who Tell Them: A Fair and Balanced Look at the Right* (2003); Thom Hartmann, *Unequal Protection: The Rise of Corporate Dominance and the Theft of Human Rights* (2002); John J. Mearsheimer, *The Tragedy of Great Power Politics* (2001); Walter Russel Mead, *Special Providence: American Foreign Policy and How It Changed the World* (2002); James Bamford, *Body of Secrets: Anatomy of the Ultra-Secret National Security Agency* (2001), especially pp.70-75; John Quigley, *The Ruses of War: American Interventionism Since World War II* (1992); Austin Murphy, *The Triumph of Evil: The Reality of the USA's Cold War Victory* (2000); L. Fletcher Prouty, *The Secret Team* (1973); Michael T. Klare, *Resource Wars: The New Landscape of Global Conflict* (2001); Michel Chossudovsky, *The Globalization of Poverty: Impacts of IMF and World Bank Reforms* (1997); William Blum, *Rogue States: A Guide to the World's Only Super Power* (2000); ------, *Killing Hope: U.S. Military Interventions Since World War II* (1995); ------, *The CIA: A Forgotten History* (1986), pp.127-128, 131, 185; Chalmers Johnson, *Blowback: The Cost and Consequences of American Empire* (2000); John Prados, *The President's Secret Wars* (1986); -------, *The President's Secret Wars: CIA and Pentagon Covert Operations form World War II Through the Persian Gulf War* (1996); Ted Gup, *The Book of Honor: Covert Lives and Classified Deaths at the CIA* (2000); K. Nair, *Devil and His Dart: How the CIA is Plotting in the Third World* (1986); Susanne Jonas, *The Battle for Guatemala: Rebels, Death Squads, and the U.S. Power (*1991).

same argument that Auty made about *market-conforming* structural changes that would reverse the curse. For more than a decade since Auty's study on PNG's macroeconomic performance, market-conforming and free trade policies have been pursued under the guidance of the IMF, the World Bank and other international aid agencies, but PNG is yet to see the promised improvement. Instead, from my personal experience during that period, social conditions have gone from bad to worse.[55] Why, then, is the IMF still insisting on trade liberalization? In my view, it is to promote neoliberal ideology that exacerbates the curse rather than preventing it.

B. Corruption and Rent-seeking Explanations

Political corruption and rent-seeking explanations form the core political economy causes and explanations of the RCT and thus deserve separate and detailed analysis. Auty had identified these two causes as being two reasons for the resource curse. Subsequent studies have expanded upon it. However, like other explanations of the resource curse, corruption and rent-seeking are subjects of earlier political economy studies before the introduction of the RCT, so we will need to trace the origin and development of these two topics as well. Corruption and rent-seeking explanations form a part of what Ross calls *state-centered* theories because it focuses on the role of governments and how they affect state distribution of resource revenues.[56] *State-centered* theories stem from a combination of the socio-cultural, societal, and institutional theories to explain how resource rents might damage a state's effort to promote economic growth.

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[55] Many Papua New Guinean intellectuals living and working in Australia, for example, in Townsville where I am living and studying, discuss these issues and hold the same opinion. Colleagues from PNG advise me from time to time on the economic, political and social situation that things have gone bad from what it used to be. Prices of goods and services have generally increased while infrastructure and public goods delivery has deteriorated. Many Papua New Guineans notice the difference and express it in the Opinion column of the two national daily newspapers, the *Post Courier* and *The National*.

[56] Ross, above, n44.

1. *Rent-Seeking Theory*

The economic concept of *rent* can be traced back to its roots in classical political economy. Adam Smith defines rent as 'the price paid for the use of land [which] is naturally a monopoly price. It is not at all proportioned to what the landlord may have laid out upon the improvement of the land, or to what he can afford to take; but to what the farmer can afford to give.'[57] Smith takes land to include fisheries, minerals, forests, agricultural crops, and such other natural resources.[58] It is from this classical root that the term *rent-seeking* emerges. Thus, *rent* used in the context of *rent-seeking* refers to 'financial income which is not matched by corresponding labour or investment in the market sense. Rent in this sense arises from manipulation of economic environment, for examples, monopolies, import and trading restrictions.'[59] In relation to government rent-seeking, it refers to economic intervention by government biased towards special interests, which burden their competitors with restrictions, and also diverts resources that might flow to provide social services to benefit the public.[60]

From this definition, resource curse theorists posit that rent-seeking can be a political behaviour, and an economic behaviour. As a political behaviour, rent-seeking can take many forms. Six examples are as follows:

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[57] Adam Smith, *An Inquiry Into the Nature and Causes of the Wealth of Nations* (1st published 1776, 1952 ed.) p.62.

[58] Smith exhaustively looks at all the types of natural resources from which rent can be collected; see pages 62-116.

[59] See *Concepts & Issues: Rent-Seeking – General Features* online at http://www.edcnews.se/Research/RentSeeking.html <Accessed 04.09.07>.

[60] Jim Saxton (Vice-Chairman of the Joint Economic Committee Report), *Rent Seeking Hobbles Economic Growth* (Washington D.C.: September 1996), available online at http://www.house.gov/jec/growth/rentseek.htm <Accessed 04.09.07>.

- Since political leaders and their bureaucratic agents consistently worry about their political survival, they are likely to engage in a simple trade where material in any shape or form is provided in turn for political loyalty and support.[61]
- State actors – politicians and bureaucrats – may deliberately engage in redistribution policy to garner and maintain their political support base. To facilitate and pursue this policy, politicians and bureaucrats turn public institutions into instruments for their own purposes. That explains resistance against institutional reforms.[62]
- Segmented societies with strictly separate and internally highly structured organisational units like ethnic, religious and regional groups are more prone to rent-seeking. This is to say that since rentier states develop poor extractive institutions, the information they need to develop effective development strategies are lacking.[63]
- Social groups and interest groups can establish links with the bureaucracy and pursue rent-seeking very effectively.[64]
- Rentier states adopt *egalitarian current consumption* policies over sustainable development projects in order to prevent social conflicts.[65]
- Finally, rent-seeking is associated with corruption. 'Rent-seeking can be described as corruption at the point where politicians and bureaucrats specifically

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[61] Hossein Mahdavy, 'The Pattern and Problems of Economic Development in Rentier-States: The Case of Iran' in M. A. Cook (ed), *Studies in the Economic History of the Middle East* (1970) p.428, at p.443.

[62] Hootan Sambayiti, 'The Rentier State, Interest Groups, and the Paradox of Autonomy: State and Business in Turkey and Iran' (1994) *Comparative Politics* p.20.

[63] Kiren Aziz Chaudhry, 'The Prize of Wealth: Business and States in Labor Remittance and Oil Economies' (1989) *International Organization* p.43.

[64] See Robinson, Torvik and Verdier, above n45, who claim to have developed a pure political model akin to the rent-seeking model.

[65] Lisa Anderson, 'The State in the Middle East and North Africa' (1987) *Comparative Politics* p.20.

exploit their current opportunities to manipulate the existing institutional framework so that in future it serves their own private interests.'[66]

The *egalitarian current consumption* mentality describes the 'get-rich-quick mentality', which is considered in the next section on socio-cultural explanations. An offshoot of this theory posits that states that are heavily dependent on resources rent and foreign aid are freed from the need to levy heavy domestic taxes, and this provides a form of incentive for the state to become less accountable to their people.[67] Some argue that this explanation is more applicable to the Middle East, especially Saudi Arabia and other sub-Saharan oil-exporting countries.[68]

The economic consequences of these types of political rent-seeking behaviour, the resource curse theorists point out, is that society at large loses the material benefits bestowed upon the interest group or monopoly.[69] As Saxton elaborates: 'The crucial thing to understand about rent seeking is that the resources spent to influence the political

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66 This summary is based on information located at http://www.edcnews.se/Research/RentSeeking.html <Accessed 04.09.07>.

67 Richard M. Auty, (1995) *Patterns of Development: Resources, Policy and Economic Growth* (1995) p.19.

68 Mahdavy, above n61; Hazem Beblawi and Giacomo Luciani (eds), *The Rentier State: Nation, State and Integration in the Arab World, Volume 2,* (1987); Eva Bellin, 'The Politics of Profit in Tunisia: Utility of the Rentier State Paradigm?' (1994) 3 *World Development* p.22; Kiren Aziz Chaudhry, 'Economic Liberalization and the Lineages of the Rentier State' (1994) *Comparative Politics* p.27; John Clark, 'Petro-politics on Congo' (1997) 3 *Journal of Democracy* p.8; Douglas A. Yates, *The Rentier States in Africa: Oil Rent Dependency and Neoliberalism in the Republic of Gabon* (1996).

69 Arnold C. Harberger first picked up this problem and discussed it in 'Monopoly and Resource Allocation' (1954) 44 (2) *The American Economic Review* pp.77-87. Others took on from there; see Henry H. Villard, 'The Social Cost of Corporate Monopoly Profits' (1957) 72 (3) *Political Science Quarterly* pp.380-387; Richard A. Posner, 'The Social Cost of Monopoly and Regulation' (1975) 83 (4) *The Journal of Political Economy* pp.807-828; Edward M. Miller, 'The Effect of Monopoly Power on National Income, Wage Income and Interest Rates' (1978) 37 (4) *American Journal of Economics and Sociology* pp.349-357; Keith Cowling and Dennis C. Mueller, 'The Social Costs of Monopoly Power' (1978) 88 (352) *The Economic Journal* pp.727-748; Joseph M. Jadlow and Janice W. Jadlow, 'Risk, Rent Seeking and the Social Cost of Monopoly Power' (1988) 9 (1) *Managerial and Decision Economics*, pp.59-63; Klaus Stegemann, 'The Social Costs of Monopoly in an Open Economy' (1984) 17 (4) *The Canadian Journal of Economics* pp.718-730.

process are wasted to society. They are profitable to the special interest that profits from politically targeted rents. [Consequently], new plants cannot be built, computers made or doctors educated with these funds.'[70] Thus, rent-seeking restricts competition and discourages or stymies innovation.[71] Unlike profit-seeking, rent-seeking does not create wealth; it merely transfers it from one party to another.[72]

The social cost of rent-seeking was first noticed by Tullock who discussed the economic implications in a paper published in 1967.[73] Tullock wrote his paper during the 1960s when monopoly power was being severely criticized.[74] Tullock did not use the word *rent-seeking*; it was Anne Krueger who first introduced the term in 1974.[75] Tullock used a simple diagram like the one below to explain that the triangle between **c**, **d** and **e** was called the welfare loss from monopoly or tariff, while the rectangle between **a, b, c** and **e** was a transfer and not a social cost.[76]

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[70] Saxton, above n60, at p.1.

[71] Michele Boldrin and David K. Levine, 'Rent-Seeking and Innovation' (2004) 51 *Journal of Monetary Economics* pp.127-160.

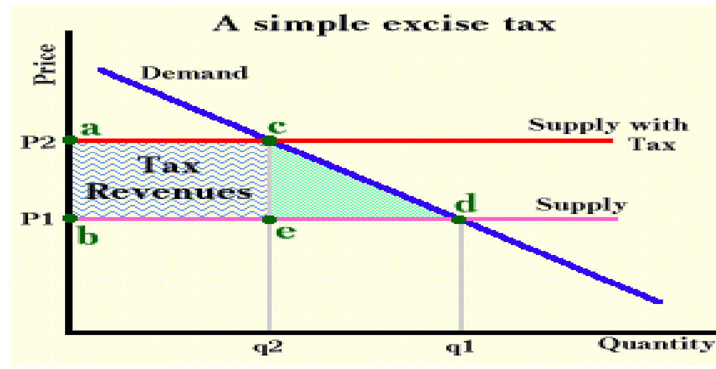
[72] Sanford Ikeda, 'Rent-Seeking: A Primer' (Foundation for Economic Education, New York, November 2003) 53 (11), *The Freeman: Ideas on Liberty*, available online at http://www.fee.org/publications/the-freeman/article.asp?aid=5341, <Access 06.09.07>.

[73] Gordon Tullock, 'The Welfare Costs of Tariffs, Monopolies and Theft', (1967) 5 *Western Economic Journal* pp.224-232.

[74] See Jonathan Eaton, 'Monopoly Wealth and International Debt' (1989) 30 (1) *International Economic Review*, pp.33-48; Dean A. Worcester, Jr., 'On Monopoly Welfare Losses: Comment', (1975) 65 (5) *The American Economic Review* pp.1015-1023; Arye L. Hillman and Eliakim Katz, 'Risk-Averse Rent Seekers and the Social Cost of Monopoly Power' (1984) 94 (373) *The Economic Journal* pp.104-110; S. C. Littlechild, 'Misleading Calculations of the Social Costs of Monopoly Power' (1981) 91 (362) *The Economic Journal* pp.348-363; William S. Commanor and Harvey Leibenstein, 'Allocative Efficiency, X-Efficiency and the Measurement of Welfare Losses' (1969) 36 (143) *Economia, New Series* pp.304-309.

[75] Anne Krueger, 'The Political Economy of the Rent-Seeking Society' (1974) 64 (3) *The American Economic Review* pp.291-303. Krueger was the World Bank Chief Economist from 1982-1986, and the First Deputy Managing of the IMF from 2001-2006.

[76] Gordon Tullock, 'The Origin Rent-Seeking Concept' (2003) 2 (1) *International Journal of Business and Economics* pp.1-2.



Source:[77] **Figure 3.2**: Social Cost of the Rent-Seeking Theory

Tullock explains that whereas he 'was interested in monopolies and tariffs in developed countries like the US, Krueger focused mainly on the quantitative import restrictions in less developed countries.'[78] Krueger chose India and Turkey, and her benchmark case was the quota. According to Tullock, 'A quota implies profit for firms that can import at low world price and sell at the higher domestic price. Firms compete for this profit by competing for the limited rights to import, which are rationed by government.'[79] Krueger assumed that governments would manage this competition through licensing regimes. In this case, the rents would accrue either to those who obtained licenses or to government administrators who obtained bribes to grant the licenses. In a competitive situation, maximizing rent-seekers would presumably be willing to invest an amount in bribes up to the amount of the expected rent.

Krueger's rent-seeking theory was developed to criticize government involvement in economic planning and development informed by Keynesian economics and modernization theory. Krueger begins by observing that government restrictions on

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77 This diagram was taken from http://ingrimayne.com/econ/government/RentSeeking.html <Accessed 04.09.07>.

78 Tullock, above n76, at p.5.

79 Id, at p.6.

economic activities in market-oriented economies are a pervasive fact of life.[80] These restrictions give rise to rents and entrepreneurs compete for these rents. However, in a market economy with no restrictions, entrepreneurs would seek to achieve windfall gains by adopting new technology, anticipating market shifts correctly, and so on. With perfect restrictions, on the other hand, regulations would be all-pervasive that rent-seeking would be the only route to gain.[81] Krueger argues that government intervention in the functioning of the free market to allow competition for rents causes social loss over and above the traditional triangle.[82] Therefore there should be less government intervention in the functioning of the market.

Krueger takes her rent-seeking behaviour of governments further in her 1990 article 'Government Failures in Development'.[83] In that article, Krueger observes that when colonies became independent after WW II, development economists advised the new governments to undertake activities that would normally be performed by the private sector. One of these activities included the need to compensate for 'market failures'. Governments were involved in allocating investments, and intensively involved in other economic activities, which would otherwise be done by private interests. The argument for government involvement was the absence of a proper functioning market as that which exists in the developed world. In her view, governments of most developing countries were mired in economic policies that were manifestly unworkable. 'Whether market failures had been present or not, most knowledgeable observers concluded that there had been colossal government failures.'[84] To her, the assumption in the 1950s that

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80 Krueger, above n75, at p.291.
81 Id., at p.302.
82 Ibid.
83 Anne O. Krueger, 'Government Failures in Development' (1990) 4 (3) *Journal of Economic Perspectives* pp.9-23.
84 Id., at pp9-10.

governments of developing countries would behave like selfless, benevolent social guardians to bring about development at the back of resource booms is wrong. The following litany of government failures by commission and omission prove that it is time government must be out of the economy and allow the free market to operate to cause growth and prosperity.

Table 3.1

Commissions

- Exceptionally high-cost public sector enterprises, engaged in a variety of manufacturing and other economic activities not traditionally associated with the public sector.
- State marketing boards, which often served as a monopoly distribution network and frequently also provided inputs (erratically, and often heavily subsidized if not free) to farmers.
- State ownership of retail shops for the distribution of foods and other items deemed essential.
- State operation of mines and manufacturing activities.
- State enterprises accorded monopoly rights for importing a variety of commodities.
- Nationalized banking, insurance operations and luxury hotels.
- Government investment programs were highly inefficient and wasteful.
- Pervasive and costly government controls over private sector activity.
- Government public sector deficits, fuelled by public sector enterprise deficits, excessive investment programs, and other government expenditures, led to high inflation, with their attendant consequences for resource allocation, savings behavior, and the allocation of private investment.

Omissions

- Deterioration of transport and communication facilities, which raised costs for many private (and public) sector activities.
- Maintenance of fixed nominal exchange rates in the face of rapid domestic inflation, buttressed by exchange controls and import licensing.
- Insistence upon nominal rates of interest well below the rate of inflation with credit rationing so that governments could supervise credit allocation among competing claimants.
- Failure to maintain existing infrastructure facilities.

Therefore, ‘a starting point is to recognize that “the government” consists of a multitude of actors: politicians who must seek political support from various groups, bureaucrats, technocrats, and so on’ who ‘exert strong disproportionate influence over policy

formulation, and policy execution' which 'is far from what had been intended.'[85] Corruption and favoritism surround bureaucratic allocation of investment licences, import licences, and the awarding of government contracts.[86] In that manner, resource wealth is squandered, and thus one could now see why resource riches lead to stagnation.

One can appreciate that since Krueger served as the First Deputy Managing Director of the IMF from 2001 to 2006, her crusade against government involvement in economic development in developing countries has had considerable impact. However, it is hypocritical of her to criticize only the governments of developing countries and not the powerful and industrialised countries of the rich North who, through trade and aid policies and their multinational corporations, seek government favours to acquire mineral and hydrocarbon extraction licenses as well as other import/export licences, investment licences and government contracts.

The rent-seeking concept appears to be related to the concept of *rentier* states or *rentier* economies.[87] After the term *rentier state* was first coined by Hossein Mahdavy to describe the pre-revolutionary Pahlavi Iran in 1970, the concept first spread among academic specialists of the Middle East to describe the oil-dependent states before it spread to the rest of the world.[88] The theory has since then been expanded in its broadest sense to include those countries that receive on a regular basis substantial amounts of external economic rent.[89] Beblawi and Luciani thought that to focus exclusively on the

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[85] Id., pp.13-14.

[86] Ibid.

[87] Michael Dauderstadt, *Dead Ends of Transition: Rentier Economies and Protectorates* online at http://fesportal.fes.de/pls/portal30/docs/FOLDER/POLITIKANALYSE/PUBLIKATIONEN/MD_DEAD+ENDS.PDF <Accessed 06.09.07>.

[88] See the various Middle East writers who contributed to Hazem Beblawi and Giacomo Luciani (eds), above n68.

[89] Madahvy, above n61.

state, independently of the economy, and to define rentier state as any state that derives a substantial part of its revenue from foreign sources in the form of economic rent was 'a rather restrictive definition that says little about the economy.'[90] Therefore, they (Beblawi and Luciani) adopted the term *rentier economy* to describe an economy in which rent plays a major role, and in which that rent is external to the economy.[91] This original definition has been extensively expanded to include an economy in which government income largely comprises revenue from resource rents rather than taxes on wages and profits, foreign aid (also called *geopolitical rent*) and *contrived rent* through political manipulation of prices.[92] A rentier-state is hence a state

> reliant not on extraction of the domestic population's surplus production but on externally generated revenues, or rents, such as those derived from oil… In this perspective, a rentier state is based on a rentier economy in which income from rent dominates the distribution of national income, and thus where rentiers wield considerable political influence… Since the rent…dominates the significant amount of the GDP, a rentier state generally lacks a productive outlook. In the literature some other terms, such as 'allocation state'… and 'distributive state'… are used interchangeably with 'rentier state.' Those alternative terms emphasize the functions of state (allocation and distribution), instead of its source of revenue (the rent).[93]

In summary, then, mineral and petroleum economies are rentier states engaged in rent-seeking behaviour. The economic consequence of this is the resource curse. Wastage, patronage, lack of savings, or failing to invest in human capital, and into productive enterprises, especially manufacturing so as to establish permanent and diversified

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90 Beblawi and Luciani (eds), above n68, at p.11.

91 Douglas Andrew Yates, *The Rentier State in Africa: Oil Rent Dependency and Neocolonialism in the Republic of Gabon* (1996) p.13.

92 Dauderstadt, above n87, at p.2.

93 Ahmet Kuru, 'The Rentier State Model and Central Asian Studies: The Turkmen Case' (Spring 2002) 1 (1) *Alternatives: Turkish Journal of International Relations*, online at http://www.alternativesjournal.net/volume1/number1/akuru.htm <Accessed 06.09.07>.

economic bases that would sustain an economy at the end of the natural resource boom all combine to cause the curse.

2. Corruption Theory

According to this theory, resource abundance engenders corruption, especially in the form of rent-seeking and clientelism, ultimately dampening economic growth. Carlos Leite and Jens Weidmann of the IMF did the first econometric study on this theory in 1999.[94] Leite and Weidmann's purpose was, first, to investigate the determinants of corruption with a special emphasis on the role of natural resource abundance, and secondly, to examine the growth effects of corruption. 'Both issues are studied theoretically, within an open economy, general equilibrium framework, as well as empirically within a simultaneous equation model with both economic growth and corruption endogenized.'[95] Resource abundance is one of four determinants the authors used in their model studies. Leite and Weidmann conclude that resource-induced corruption always slows growth. 'Empirically, the growth regressions unambiguously corroborate the negative growth effect of corruption and support our initial hypothesis of the corruption channel being an important explanation for the slow growth of resource-rich countries.'[96]

Subsequent studies support this finding. For example, Damania and Bulte suggest that in the absence of political competition, governments are likely to accept bribery from special interest groups lobbying for permits or licences to extract natural resources. One

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94 Carlos Leite and Jens Weidmann, 'Does Mother Nature Corrupt? - Natural Resources, Corruption, and Economic Growth' (IMF Working Paper WP/99/85, Washington D.C., July 1999). Copy available online at http://www.imf.org/external/pubs/ft/wp/1999/wp9985.pdf <Accessed 07.09.07>.

95 Id., at p.3.

96 Id., at pp.30-31.

result of such an incidence would be neglect of the manufacturing sector, which could engender Dutch disease effects on the economy.[97]

Although corruption is an ancient problem,[98] neoclassical economists have not seriously studied its association with resource endowment and its impact on economic growth and development until recently.[99] Indeed there were earlier studies on corruption but the subject was of interest primarily to criminologists, sociologists, psychologists and political scientists.[100] Opinion among those earlier studies was divided between those who saw corruption as 'grease' necessary to lubricate the wheels of development,[101] those who disagreed and saw it as 'weed suffocating better plants',[102] and those who remained neutral until further and better empirical results based on reliable and systematic studies were obtained.[103]

Econometric studies on corruption as being bad for economic growth and development took prominence only in the 1990s. For this reason, Robert Williams writes: 'The 1990s have been the decade of corruption as an academic and policy topic and there is no

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97 Richard Damania and Erwin Bulte, 'Resources for Sale: Corruption, Democracy and the Natural Resource Curse' (Centre for International Economic Studies, Discussion Paper No. 0220, University of Adelaide, 2003) at p.31.

98 See Pranab Bardhan, 'Corruption and Development: A Review of Issues' (1997) 35 (3) *Journal of Economic Literature* p.1320.

99 Alberto Ades and Rafael Di Tella, 'Rents, Competition and Corruption' (1999) 89 (4) *The American Economic Review* p.982.

100 Arnold A. Rogow and Harold D. Laswell, *Power, Corruption and Rectitude*, (1963). Rogow and Laswell studied the personal lives of politicians and bureaucrats in the U.S. and have developed a model of psychological profile of the politician that relates to unfulfilled childhood needs and corrupt behaviour. See also Susan Rose-Ackermann, *Corruption: A Study in Political Economy* (1978); James Scott, *Comparative Political Corruption* (1972).

101 Nathaniel H. Leff, 'Economic Development Through Bureaucratic Corruption' (1964) *The American Behavioral Scientist* pp.8-14. David H. Bayley, 'The Effects of Corruption in a Developing Nation' (1966) 19 (4) *The Western Political Quarterly* pp.719-732; S. P. Huntington, *Political Order in Changing Society* (1968).

102 Ronald Wraith and Edgar Simpkins, *Corruption in Developing Countries* (1963) p.63.

103 J. S. Nye, 'Corruption and Political Development: A Cost-Benefit Analysis' (1967) 61 (2) *The American Political Science Review* pp.417-427.

indication that popular, academic, professional or political interest is beginning to flag.'[104] Consequently, literature on this issue is voluminous.

Paulo Mauro did the first serious systematic cross-country analysis using indicators of bureaucratic honesty and efficiency to economic growth in 1995.[105] Mauro adopted the Business International's (BI)[106] indices on 56 'country risk' factors for 68 countries for the period 1980-1983, and on 30 country risk factors for 57 countries for the period 1971-1979. In order to identify the channels through which corruption and other institutional factors affect economic growth, Mauro selected only nine indices out of the 56 country risk indices.[107] The BI indices are integers between 0 and 10. A high value of the index means that the country in question has good institutions. Using these indices, for

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104 Robert Williams, 'New Concepts for Old?' (1999) 20 (3) *Third World Quarterly* p.503.

105 Paolo Mauro, 'Corruption and Growth' (1995) 110 (3) *The Quarterly Journal of Economics* pp.681-712.

106 BI is a private firm that sells these indices to banks, multinational corporations and other international investors. The 9 indices Mauro used are: (1) *Political Change – institutional*. 'Possibility that the institutional framework will be changed within the forecast period by elections or other means; (2) *Political Stability – social*. 'Conduct of political activity, both organized and individual, and the degree to which the orderly political process tends to disintegrate or become violent; (3) *Probability of Opposition Group Takeover*. 'Likelihood that the opposition will come to power during the forecast period; (4) *Stability of Labour*. 'Degree to which labor represents possible disruption for manufacturing and other business activity; (5) *Relationship with Neighboring Countries*. 'This includes political, economic and commercial relations with neighbors that may affect companies doing business in the country; (6) *Terrorism*. 'The degree to which individuals and businesses are subject to acts of terrorism; (7) *Legal System, Judiciary*. 'Efficiency and Integrity of the Legal Environment as it affects business, particularly foreign firms; (8) *Bureaucracy and Red Tape*. The regulatory environment foreign firms must face when seeking approvals and permits. The degree to which it represents an obstacle to business; and (9) *Corruption*. 'The degree to which business transactions involve corruption or questionable payments.' The 9 indices Mauro used are: (1) *Political Change – institutional*. 'Possibility that the institutional framework will be changed within the forecast period by elections or other means; (2) *Political Stability – social*. 'Conduct of political activity, both organized and individual, and the degree to which the orderly political process tends to disintegrate or become violent; (3) *Probability of Opposition Group Takeover*. 'Likelihood that the opposition will come to power during the forecast period; (4) *Stability of Labour*. 'Degree to which labor represents possible disruption for manufacturing and other business activity; (5) *Relationship with Neighboring Countries*. 'This includes political, economic and commercial relations with neighbors that may affect companies doing business in the country; (6) *Terrorism*. 'The degree to which individuals and businesses are subject to acts of terrorism; (7) *Legal System, Judiciary*. 'Efficiency and Integrity of the Legal Environment as it affects business, particularly foreign firms; (8) *Bureaucracy and Red Tape*. The regulatory environment foreign firms must face when seeking approvals and permits. The degree to which it represents an obstacle to business; and (9) *Corruption*. 'The degree to which business transactions involve corruption or questionable payments.'

107 Mauro, above n105, at p.684.

examples, BI rated Singapore 10 out of 10 for the period 1980-1983, while Zaire had the worst among the countries in the sample. Singapore also had the highest investment rate during the 1960-1985 period, while Zaire's was extremely low.[108] Mauro concludes that corruption is negatively associated with institutions, investments and growth.[109] While Mauro's empirical study supports the institutional theories generally, it does not look at the link between corruption, resource abundance and economic growth. Leite and Weidman above took up that specific issue.[110]

Another study relevant to this issue was one conducted by Shleifer and Vishny who looked at bribery as an incidence of corruption and argued that corruption tends to lower economic growth.[111] The issues they examined were: (1) the implications of corruption network in countries such as Russia and South Korea where investors pay bribes for government goods and services; and (2) why corruption is more distortionary than taxation. They conclude that bribery thrives in such countries because the central government is weak, so government agents take bribes from private agents and investors seeking permits, licences and so on.[112] The second reason bribery thrives is because of secrecy. 'The demands for secrecy can shift a country's investments away from the highest value projects, such as health and education, into potentially useless projects, such as defence and infrastructure, if the latter offer better opportunities for secret corruption.'[113]

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108 Mauro, above n105, at p.686.
109 Id., at p.705.
110 Leite and Weidmann, above n94.
111 Andrei Shleifer and Robert W. Vishny, 'Corruption', (1993) 108 (3) *The Quarterly Journal of Economics* pp.599-617.
112 Id., at p.615.
113 Id., at p.616.

Apart from the few who argue that corruption is good for growth, the vast majority see it as an impediment to growth. The intensity of this impediment increases in resource abundant countries because of rent-seeking activities by companies who want government favours, and government agents who want bribes.

C. Institutional Causes and Explanations

The more recent literature on the RCT tends to point out to institutional origins of the resource curse based on the assumption that institutions encourage corruption and rent-seeking. For purposes of clarity, I have grouped these institutional causes and explanations under seven different headings. These are (1) *grabber-friendly-producer-friendly* theory, (2) *point-source* theory, (3) *constitutional* theory, (4) *waste* theory, (5) *structured contingency* theory, (6) *structures and disembodied forces* theory, and (7) *settlement mortality* theory.

Robinson, Torvik and Verdier emphasise that 'the overall impact of resource booms on the economy depends critically on institutions since these can determine the extent to which political incentives map into policy outcomes.'[114] In their view, the 'relevant institutions here will be political ones which promote the accountability of politicians, and generally develop state institutions away from patrimonial practices towards the use of rational and meritocratic criteria in allocating public sector resources.'[115] They believe that 'countries with institutions that promote accountability and state competence will tend to benefit from resource booms since these institutions ameliorate the perverse political incentives that such booms create. Countries without such institutions however

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114 Robinson and others, above n45, at p.450
115 Ibid.

may suffer from a resource curse.'[116] This is because *good institutions* prevent clientelism or political patronage, rent-seeking and corruption.

1. Grabber-Friendly-Producer-Friendly Theory

If *good institutions* can promote growth by preventing rent-seeking, corruption, clientelism, and patronage as Robinson, Torvik and Verdier claim, the question is, what are *good institutions*? According to Halvor Mehlum, Karl Moene and Ragnar Torvik's *grabber-friendly-producer-friendly theory*, countries with good institutions are those that can cause resource abundance to attract entrepreneurs into production, whereas in countries with weak institutions, entrepreneurs are diverted away from production into unproductive rent appropriation.[117] In their hypothesis, there are two types of institutions in natural resource-rich developing countries: *grabber-friendly* institutions and *producer-friendly* institutions. *Grabber-friendly* institutions are bad institutions that are characterized by:

- dysfunctional democracies which invite political rent appropriation;
- low transparency that invites bureaucratic corruption;
- weak property rights that cover shady dealings, unfair takeovers and expropriation;
- inadequate protection of citizens' rights which invites fraud and venal practices; weak rule of law inviting crimes, extortion and mafia activities; and
- a weak state inviting warlordism.

[116] Ibid.
[117] Halvor Mehlum, Karl Moene and Ragnar Torvik, 'Cursed by Resources or Institutions?' (2006) *The World Economy* p.1117.

Rent-seeking behaviour flourishes in this type of environment. Where there are *producer-friendly* institutions, on the other hand, rent-seeking activity is less effective because of a strong rule of law, high bureaucratic quality, low corruption, secure property rights, and good governance and overall transparency.[118] This means good institutions are those that promote and pursue the ten *Washington Consensus* agenda.[119]

2. Point-Source Theory

According to Murshed's *point-source* theory, which he borrows from Woolcock, Pritchett and Isham[120] and Boschini, Pettersson and Roine's *appropriability* theory, not all natural resources but only hydrocarbon and minerals affect the quality of institutions. For Murshed, revenue flows from oil, gas and minerals are *concentrated* compared to revenue flows from agricultural commodities, which are *diffused*. Concentrated revenue flows lead to a greater propensity to engage in rent-seeking and unproductive activities when compared to diffuse resources. This in turn causes institutional malfunction, especially in the absence of effective institutional restraint on greed and corruption, leading to adverse effects on a nation's overall economic growth.[121]

Similarly, Boschini et al. theorize that valuable and easily accessible mineral resources such as diamond and gold are potential sources of conflict and rent-seeking relative to

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118 Id., at pp.1121-1122.

119 John Williamson, 'What Washington Means by Policy Reform' in J. Williamson (ed), *Latin American Adjustment: How Much Has Happened?* (1990); John Rapley, *Understanding Development: Theory and Practice in the Third World*, (2nd ed., 2002), see esp. ch3.

120 Michael Woolcock, Lant Pritchett and Jonathan Isham, 'The Social Foundations of Poor Economic Growth in Resource-Rich Countries' in Richard M. Auty (ed), *Resource Abundance and Economic Development* (2001) pp.76-92.

121 S. Mansoob Murshed, 'When Does Natural Resource Abundance Lead to a Resource Curse?' (Environment Economics Paper Discussion Paper 04-01, International Institute for Environmental and Development, London, 2004) at p.27.

other natural resources like wheat.[122] While precious minerals are good for an economy, they will act as a source of curse in countries that have low quality institutions. This is to say that the quality of institutions is not decisive in causing the curse if a resource endowment is easy to access like wheat, timber, or fisheries, whereas minerals and hydrocarbon require sophisticated technology, so institutions are critical.[123]

3. Constitutional Theory

Jorgen Juel Andersen and Silje Aslaksen of the Norwegian University of Science and Technology advance a constitutional theory to propose that the constitutional arrangement of a country affects the manner in which resource abundance is managed.[124] The crux of their theory is that (based on empirical results of their study) countries that have presidential and non-democratic forms of governments are cursed by resource abundance, whereas democratic countries with parliamentary system of governments are not.[125] They suggest that their empirical findings support other literature on the issue that presidential regimes pursue inferior growth-promoting structural policies compared with parliamentary regimes. They admit that while constitutions do not significantly affect growth directly, they nevertheless have a negative interaction with resource abundance.[126]

However, other empirical studies disagree with this finding. For instance, Glaeser, La Porta and Lopez-de-Silanes point out that undemocratic countries such as the East Asian 'economic tigers', especially communist China, would not support the constitutional

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[122] Anne D. Boschini, Jan Pettersson and Jesper Roine, 'Resource Curse or Not: A Question of Appropriability' (SSE/EFI Working Paper Series in Economics and Finance, No.534, 2005), available online at http://www.ifw-kiel.de/VRCent/DEGIT/paper/degit_11/C011_050.pdf <Accessed 10.08.07>, at p.3.

[123] Id., at p.4.

[124] Jorgen Juel Andersen and Silje Aslaksen, 'Constitutions and the Resource Curse' (Working Paper Series No. 11/2006), available online at http://ideas.repec.org/e/pan115.html. <Accessed 10.08.07>.

[125] Id., at p.18.

[126] Ibid.

theory.[127] Instead, they point to education and human development as the key factors. Education and human development is taken up under the human capital theory below.

4. Waste Theory

Three IMF studies dated July 2003, June 2006 and March 2007 make further extension to the above institutional theories.[128] The 2003 and 2006 studies largely attribute resource curse to the waste theory, while the 2007 study focuses on trade liberalization, which is presented above.

The 2003 study firstly reviews the curse literature and agrees with the institutional theories that the quality of institutions is impaired by *point-source* natural resources only. This conclusion was arrived at after measuring natural resource endowment and growth in three different ways by extending Sachs and Warner's exports of natural resource ratio to GDP. Sachs and Warner's original test is extended by including:

- the share of exports of four types of natural resources – oil and gas, ores and metals, agricultural raw materials, and foods – in GDP and total exports;
- the share of exports of all natural resources in total exports; and
- a dummy for oil producing countries.[129]

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[127] Edward L. Glaeser, Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, 'Do Institutions Cause Growth?' (2004) 9 *Journal of Economic Growth* pp.271-303.

[128] In order of time, these are: 1. Xavier Sala-i-Martin and Arvind Subramanian, 'Addressing the Natural Resource Curse: An Illustration from Nigeria' (IMF Working Paper No. WP/03/139, Washington D.C.: July 2003); 2. Atsushi Iimi, 'Did Botswana Escape from the Resource Curse?' (IMF Working Paper No. WP/06/138, Washington D.C.: June 2006); 3. Rabah Arezki and Frederick van der Ploeg, 'Can the Natural Resource Curse Be Turned Into a Blessing? The Role of Trade Policies and Institutions' – IMF Working Paper No. WP/07/55, Washington D.C.: March 2007).

[129] Sala-i-Martin and Subramanian, id., at p.8.

After testing these natural resource variables against institutional variables such as the rule of law, freedom of speech and accountability, government effectiveness, public corruption, and political stability, the authors conclude that:

- Some natural resources appear to have strong, robust and negative effect on growth by impairing institutional quality. Once institutional quality is attended to, there is very little effect of natural resources on growth, or even a positive effect.
- *Point-source* natural resources (oil, gas and minerals) have a very systematic and negative effect on growth via their detrimental effect on institutional quality. The other types of natural resources do not seem to affect institutional quality.
- The impact of natural resources is non-linear. The negative marginal impact of resources on institutional quality depends on and increases with their level.[130]

The dummy for oil-producing countries is tested against the Nigerian oil economy. The study notes that since Nigeria's independence, the country's development has been affected by the Dutch disease and waste. Of these two, however, waste 'appears to be overwhelming, with oil as a key factor causing a whole series of pathologies that have led to the waste.'[131] The study finds that *waste* came about as a result of public investment. Since 1965, Nigeria rapidly accumulated physical capital averaging 6.7 percent per year, but negative growth averaging 1.2 percent per year. Oil was responsible for the physical capital accumulation is telling:

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[130] Id, at p.13.
[131] Ibid.

- Between 1973 and 1980, the two years of the major oil price shocks, the capital stock grew at an average rate of 14 percent per year, which represented a three-fold increase in the country's capital stock in 8 years.
- A substantial part of the increase was accounted for by public capital spending financed by the surging oil revenues.
- Public investment as a share of GDP rose by over 7 percentage points during the period of oil shocks.
- Between the 1960s and the end of the second oil shock the share of the public sector in capital formation increased from 20 percent to 55 percent.[132]

Another piece of evidence relates to capacity utilization in manufacturing, which is substantially owned by the Nigerian government. Capacity utilization averaged 77 percent in 1975, but then quickly declined to about 50 percent in 1983. By the mid-1980s, capacity utilization dropped to 40 percent and remained around 35 percent. This is to say that 'two-thirds of the investment in manufacturing by the government is consistently wasted. The overall picture that emerges is that Nigeria has over-invested in physical capital and has suffered from poor productivity. Quality has suffered at the expense of quantity.'[133] This finding is supported by Bevan, Collier and Gunning who observe: 'This conjunction of a powerful political impetus to public investment and a lack of civil service skill is what makes Nigeria's economic history in this period so spectacular: almost the entire windfall was invested, and yet…there was nothing to show for it.'[134]

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[132] Id, at p.14.
[133] Ibid.
[134] D. Bevan, P. Collier and J. W. Gunning, *The Political Economy of Poverty, Equity, and Growth: Nigeria and Indonesia* (1999), quoted in IMF 2003, ibid.

The question is: what happened to the oil wealth? The IMF study answers this question by pointing out that Nigerian politics was fundamentally changed by the motivation to get access to the oil revenues. Inter-regional wars that have been waged since the 1960s, successive military dictatorships, transfers of large undisclosed amounts of funds, large public sector dominated by those from the North, political patronage, building of unproductive government factories like the Ajakouta steel complex in the 1970s, increased government expenditure to cater for clientelistic arrangements and increased kickbacks, all combine to demonstrate wastage of oil revenue.[135]

The 2006 IMF study, on the other hand, looks at the success story of Botswana to demonstrate that good governance and good institutions can lead to growth at the back of resource abundance. 'The reason Botswana has…achieved marked growth to date seems to be that it has sound institutions and good governance.'[136] Many other studies support this finding, but some place emphasis on Botswana's *good policies*,[137] while others on *good institutions*.[138]

So, what these IMF studies convey is that there is no *waste* where there are good institutions and good governance like Botswana. Natural resources, like Botswana's rich diamonds, can then become a blessing.

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135 Sala-i-Martin and Subramanian, above n128, at p.14.
136 Iimi, above n128, at p.9.
137 Scott A. Beaulier, 'Explaining Botswana's Success: The Critical Role of Post-Colonial Policy' (2003) 23 (2) *Cato Journal* p.227.
138 Daron Acemoglu, Simon Johnson and James A. Robinson, *An African Success Story: Botswana* (11 July 2001) at http://ksghome.harvard.edu/~drodrik/Growth%20volume/Acemoglu-Botswana.pdf <Accessed 30.08.07>.

5. *Structured Contingency Theory*

Two independent studies, one by Terry Lynn Karl (*structured contingency theory*) and the other by Michael Schafer (*structures and disembodied forces theory*), implicitly support these IMF findings as well as the *point-source* theory on the view that good institutions alone are not sufficient to transmit growth from resource abundance. According to Karl's study published in 1997, three institutions, namely,

- the *state*, defined as the permanent organizational structure that comprises bureaucracies, institutionalized legal order, and formal and informal norms by which decisions are made and enforced through the use of legitimate force;
- the *regime* which includes the method of selection of the government, forms of representation, patterns of repression, and such ensemble of patterns within the state that determines the forms and strategies of access to the process of decision-making - the actors who are admitted (or excluded) from access to decision-making - and the rules that determine how lawful decisions can be made; and
- the *government* comprising the actors (party politicians, civil administrations, military administrators, etc.) who occupy important positions within the regime at any given moment in time,[139]

are influenced and shaped by a country's origin and dependence on a particular revenue base in a distinctive manner, and in turn, is shaped by them. This is to say that if a country has depended on mineral and hydrocarbon revenue for some time, they affect the three government institutions to become dependent on these resources. A symbiotic relationship exists in which resource abundance influences political institutions and

[139] Terry Karl Lynn, *The Paradox of Plenty: Oil Booms and Petro-States* (1997) p.14.

political institutions are, in turn, influenced by the *point-source* resources. Karl's thesis is that oil or mineral resources not only create rent seeking, clientelism and patronage, but these resources also affect the three institutions too.[140]

How should this cycle of dependence and curse be broken? According to Karl there is no hope because oil- and mineral-dependent countries face insurmountable obstacles in attempting to exit from old patterns and have low capacities to promote new ones. Organized interests and state bureaucrats tend to fight and resist revolutionary reforms of their resource regimes and mode of operations. Strong incentives for maintaining a mineral- and hydrocarbon-based development model and the converse disincentives for change 'lock-in' such states from seeking alternative development paths. These obstacles are more pronounced and difficult for states dependent on petroleum than minerals because of the extraordinarily high income from oil. These extraordinary rents, extracted without added investment, ultimately increase difficulties in adjustment. Simultaneously, they expand state jurisdiction and weaken its authority by encouraging and entrenching rent-seeking activities by both private-interest groups and the public sector. Institutional molding by oil rents is so overwhelming that Karl calls petroleum-exporting countries *petro-states*.[141] In my view, Karl is implicitly referring to characteristics of neocolonialism but she does not explicitly state the obvious.

6. Structures and Disembodied Forces Theory

Like Karl, Shafer who studied the Zambian mining sector, Sri Lanka's industrial plantation crops sector, Costa Rica's peasant cash crop sector and South Korea's light manufacturing sector adopts a theory similar to Karl's *structured contingency theory*.

[140] Id., at p16.
[141] Id., at pp.15-16.

Schafer examines two questions based on his experiences of two African mining countries, Zaire and Zambia. The key questions in his *structures and disembodied forces* theory are: 'If mining structures mining states' domestic political economies in distinctive ways, and international mineral markets structure their engagement in the international economy in distinctive ways, do other industries structure states' domestic and international circumstances as distinctively? And if so, what shared logic or causal process would permit meaningful comparisons of countries in different categories?'[142]

Schafer looks at the relationships between what he calls *structures* and *disembodied forces* against individuals and self-interest. By implication, Shafer hopes his model would also help foster an understanding of the North-South battle over who is to blame. In preempting an answer to the questions he posed, Shafer observes: 'I find the first [question] sterile and the second [question] offensive, especially in the context of applied policy analysis. Of course structures matter, but structures do not act, people do…'[143] But instead of studying the cognitive factors that motivate people to behave in certain ways, Shafer, like Karl, attempts to offer 'an explanation *with* and *of* structures and *agents*.'[144] Just as Shafer's questions are confusing, his conclusions are also not very clear. What he seems to say is that performances of resource-rich developing countries widely vary. Generally, the leading export sector of a nation influences the institutional capacity and autonomy of the state itself. For instance, vertically integrated oil and mineral companies – large in economic size and power but small in number – can take collective action place exceptionally strong demands on the state during market swings. On the other hand, when many small firms control the leading export sector like

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[142] D. Michael Shafer, *Winners and Losers: How Sectors Shape the Developmental Prospects of States* (1994) px.

[143] Id., at pxi.

[144] Ibid.

agriculture and manufacturing, their smallness can help to cope with international price fluctuations.

7. Settlement Mortality Theory

While most of the above institutional theories use endogenous factors in their modeling, a 2001 study by Daren Acemoglu, Simon Johnson, and James A. Robinson introduce an exogenous variable into institutions.[145] Their theory posits that European settler colonies like the United States, New Zealand, Australia and Canada have good institutions and are not cursed, whereas extractive colonies have bad institutions and hence are cursed by resource abundance.[146] The theory is built on three premises:

- European colonization policies resulted in the creation of two types of states: *extractive states* which eventually became *neo-colonial* states, and *settler colonies* which became *Neo-Europes*.[147] The *settler colonies* replicated European institutions, with strong emphasis on private property, the rule of law, democratic institutions and checks and balances against government power. On the other hand, the *extractive colonies* such as the Belgian colonization of the Congo did not replicate the European institutions as the *settler colonies* did. 'In fact, the main purpose of the extractive state was to transfer as much of the resources of the colony to the colonizer.'[148]
- 'Disease environment', meaning whether or not a territory was infested with diseases such as malaria and yellow fever against which Europeans had no natural

[145] This theory was developed by Daren Acemoglu, Simon Johnson, and James A. Robinson, 'The Colonial Origins of Comparative Development: An Empirical Investigation' (2001) 91 (5) *The American Economic Review* pp.1369-1401.
[146] These authors do not consider the cursed conditions of indigenous peoples in these countries.
[147] Alfred Crosby, *Ecological Imperialism: The Biological Expansion of Europe 900-1900* (New York: 1986).
[148] Acemoglu et al., above n145, at p.1370.

immunity, influenced colonization policy. *Neo-Europes* were created in friendly environments similar to that of Europe - in the temperate regions - whereas *extractive states* were established in the tropical regions which were infested with tropical diseases.

- The colonial state and institutions in both *extractive* states and *settler* colonies persisted even after independence.[149]

Based on these three premises, the proponents of the *settlement mortality theory* use mortality rates of the first European settlers in the colonies as an instrument for current institutions. By plotting the logarithm of GDP per capita today against the logarithm of the settler mortality rates per thousand for a sample of 75 countries, the proponents establish that '[c]olonies where Europeans faced higher mortality rates are today substantially poorer than colonies that were healthy for Europeans. [The] theory is that this relationship reflects the effect of settler mortality working through the institutions brought by Europeans.'[150]

Current institutions, which are the focus of the study, are property rights and checks against government power. Using the Political Risk Service index (PRSI) to determine the risk of expropriation, the study demonstrates that there is a relationship between settler mortality rates and current institutions. The regression result 'show that the mortality rates faced by the settlers more than 100 years ago explains over 25 percent of the variation in current institutions.'[151] European mortality rates[152] 'affected settlements;

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[149] Id., at p.1370.
[150] Ibid.
[151] Id., at p.1371.
[152] Philip D. Curtin, *The Image of Africa* (1964); ---------, 'Epidemiology and the Slave Trade' (1968) 83 (2) *Political Science Quarterly* pp.181-216; -----------, *Death By Migration: Europe's Encounter with the Tropical World in the 19th Century* (1989).

settlements affected early institutions; and early institutions persisted and formed the basis of current institutions.'[153]

After reviewing the atrocities of colonialism in extractive colonies, Acemoglu et. al. acknowledge that the *colonial institutions and practices persist long after independence*.[154] Acemoglu et. al. then conclude that *institutions* and colonial settlement policies are at the root of the large differences in per capita income across countries. Whereas settler colonies laid the foundation for solid institutions, extractive colonies did not, and it is this historical difference in institutional formation that points to the root cause of the curse.[155] Young concurs and observes that '*although we commonly described the independent polities as 'new states', in reality they were successors to the colonial regime, inheriting its structures, its quotidian routines and practices, and its more hidden normative theories of governance*.'[156]

Many subsequent studies support this conclusion by some emphasizing institutions while others geography. For example, Rodrik, Subramanian and Trebbi argue that institution is the most important factor than policy issues or geographical position from the tropics.[157] However, Easterly and Levine argue that tropical location is critical because there is 'evidence that tropics, germs, and crops affect development through institutions.'[158] The

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153 Acemoglu et al., above n145, at p.1373.
154 Id., at p.1376. Emphasis added.
155 Id., at p.1395.
156 Crawford Young, *The African Colonial State in Comparative Perspective* (1994) p.283. Emphasis added.
157 Dani Rodrik, Arvind Subramanian and Francesco Trebbi, 'Institutions Rule: The Primacy of Institutions Over Geography and Integration in Economic Development' (2004) 9 *Journal of Economic Growth* pp.131-165.
158 William Easterly and Ross Levine, 'Tropics, Germs, and Crops: How Endowments Influence Economic Development' (2003) 50 *Journal of Monetary Economics* p.3.

arguments are now drawn between three camps: those who emphasize *institution*, *policies*, and *geography*.[159]

Acemoglu et. al. have taken their argument further to say that high volatility experienced in the underdeveloped countries after World War II was not because of distortionary macroeconomic *policies* as popularly explained, but because of *institutional* problems.[160] This theory points out that the root causes of the RCT stems from colonialism, imperialism and neocolonialism. The resource curse is suffered in countries that were established as *extractive* colonies and not as *Neo-Europes*.

D. Other Political Economy Explanations

Four other political economy causes and explanations that remain to be examined are what may be called the *human capital theory*, the *resource-intensity theory*, the *predation theory*, and the *resource wars* theory. We will look at each one of these explanations below to complete this section.

1. Human Capital Theory

The human capital theory posits that natural resource abundance leads to neglect of human development through education, which ultimately affects quality institutions, national growth, and development. This is the proposition of Gylfason who examines four *channels of transmission* from abundant natural resources to stunted economic

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[159] The origin of the geographical arguments can be traced to location theory of the 1950s. See Douglas C. North, 'Location Theory and Regional Economic Growth' (1955) 63 (3) *The Journal of Political Economy* pp.243-258.

[160] Daron Acemoglu, Simon Johnson, James Robinson and Yunyong Thaicharoen, 'Institutional Causes, Macroeconomic Symptoms: Volatility, Crisis and Growth' (2003) 50 *Journal of Monetary Economics* pp.49-123.

performance.[161] These four channels of transmission are (1) neglect of education (2) Dutch disease, (3) rent-seeking and (4) overconfidence. Here, we are concerned with neglect of education only.

Gylfason posits that nations that are confident that their natural resources are their most important asset may inadvertently or even deliberately neglect the development of their human resources by failing to give adequate attention and funding to education.[162] Gylfason explains that more and better education is a prerequisite for rapid economic development around the world because education stimulates economic growth and improves people's lives through many channels such as increasing the efficiency of the labor force, by fostering democracy, thereby creating better conditions for good governance, by improving health, and by enhancing equality.[163]

If that is so, then how does resource abundance affect a nation's commitment to education? By plotting through the public expenditure on education among several countries from 1980 to 1997, Gylfason believes that abundant resources weaken public and private incentives to accumulate human capital.[164] He then suggests that the negative effect of resource abundance on economic growth noted since the 1960s must be contributed to by lack of human development.[165]

In Gylfason's view, natural resource-based industries are, as a rule, less high-skill labour intensive and less high-quality capital intensive compared to other industries, and

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[161] Thorvaldur Gylfason, 'Natural Resources, Education and Economic Development' (2001) 45 *European Economic Review* p.847.
[162] Id., at p.850.
[163] Id., at p851.
[164] Id at p.855.
[165] Id., at p.855.

consequently causes relatively few external benefits on other industries. Further, workers released from primary industries, such as agriculture, fisheries, forestry, or mining generally have relatively limited general labour-market relevant education to offer new employers in other industries. There are exceptions, though, such as high-tech oil-drilling operation and modern agriculture. 'But insofar as high-skill labour and high-quality capital are less common in primary production than elsewhere, this may help explain why natural resource abundance and the associated preponderance of primary production and primary exports tend to impede learning by doing, technological advance, and economic growth.'[166]

A separate study by Elissaios Papyrakis and Reyer Gelagh supports Gylfason's thesis.[167] In fact they go a bit further to assert that '*the schooling transmission channel is almost twice as important as the corruption channel. Natural resource booms lead to a decline in the manufacturing sector for which human capital is an important production factor. …Our result that schooling is more important and more significant transmission channel than corruption contrasts with the empirical results in Sachs and Warner…*'[168]

Glaeser, La Porta, Lopez-de-Silanes and Shleifer have done a comparative and empirical research to determine whether *sound institution* or *human capital* accumulation is more critical to economic growth.[169] Based on their research and empirical results, they persuasively argue that *human capital* is more critical of the two. This is evident in their concluding remarks:

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[166] Id., at p.856.

[167] Elissaios Papyrakis and Reyer Gerlagh, 'The Resource Curse Hypothesis and Its Transmission Channels' (2004) 32 *Journal of Comparative Economics* p.181.

[168] Id., at p.189. Emphasis added.

[169] Edward L. Glaeser, Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, 'Do Institutions Cause Growth?' (2004) 9 *Journal of Economic Growth* pp.271-303.

> In particular, the existing research does not show that political institutions rather than human capital have a causal effect on economic growth. Indeed, much evidence points to the primacy of human capital for both growth and democratization. … The economic success of East Asia in the post war era, and of China most recently, has been a consequence of good-for-growth dictators, not of institutions constraining them. … More recently, it might be less profitable to look for the "deep" factors explaining economic development than for policies favoring human and physical capital accumulation… Our evidence suggests [that]…countries that emerge from poverty accumulate human and physical capital under dictatorships, and then, once they become richer, are increasingly likely to improve their institutions.[170]

Other recent works on the resource curse thesis are realizing the critical role of education in economic growth and development. In a 1999 study by Leamer, Maul, Rodriguez and Schott comparing East Asia with Latin America, the authors observe that East Asian education is more broad-based and related to manufacturing than Latin America which has more uneducated labour force in the agricultural sector.[171] The authors also point out that it may be useful to learn from the policies and practices of Scandinavian countries, which have a history of both promoting education and attracting successful capital-intensive industries.[172] Despite its surplus funds from oil, Norway provides an excellent model where education is one of the most important key government priorities.[173]

In challenging the resource curse thesis, Wright and Czelusta argue that education was one of the critical factors that put the United States in a leading position in natural

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[170] Id., at pp. 297-98.
[171] Edward E. Leamer, Hugo Maul, Sergio Rodriguez and Peter K. Schott, 'Does Natural Resource Abundance Increase Latin American Income Inequality?' (1999) 59 *Journal of Development Economics* pp.3-42.
[172] Id., at p.42.
[173] Norway was ranked 1st out of 177 countries on the United Nations' Human Development Index posted online at http://hdr.undp.org/hdr2006/statistics/countries/country_fact_sheets/cty_fs_NOR.html <Accessed 03.09.07>. On Norway's huge oil reserve funds, see http://www.regjerringen.no/en/dep/fin/Selected-topics/ <Accessed 31.08.07>.

resource development technology.[174] 'By the late nineteenth century, the US emerged as the world's leading educator in mining engineering and metallurgy.'[175] For instance, by 1917, 7,500 mining engineers were produced. Based on the US historical experience, Wright and Czelusta argue that natural resources must not be seen as mere 'gifts of nature' or 'resource endowments'. 'They are better understood as the results of investment of various kinds – in capital, infrastructure and knowledge in a broad sense.'[176]

Like Wright and Czelusta, someone also challenged the common perception that the East Asian 'economic tigers' like Singapore are resource-poor:

> The fact is that throughout human history, there has ever been only one natural resource, and that is **human ingenuity and creativity**. A lump of iron ore is just a thing lying in the ground. Without human hands to shape it, without human intelligence and ingenuity to put that iron to use, a lump of iron ore has no meaning, no purpose and no use. Crude oil pumped from the ground is just black goo. Prior to the invention of machines that use petroleum as fuel, crude oil had absolutely no value whatsoever, was not considered a "resource". The only reason why things in the ground and sea can be extracted, and refined, moulded and manipulated into things of value, is because humans have exercised their ingenuity and creativity into thinking up these processes.[177] (Bold original).

The human capital theory is indeed very forceful and persuasive! It is my view that lack of education and appropriate training is one of the main causes of underdevelopment in PNG.

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174 Gavin Wright and Jesse Czelusta, *Exorcising the Resource Curse: Minerals as a Knowledge Industry, Past and Present* (Stanford University, July 2002), online at http://www-econ.stanford.edu/faculty/workp/swp02008.pdf <Accessed 04.06.07>.

175 Id., at p.7.

176 Cited by Matt Smith, *Resources Do Not Impede Development, Study Finds* (1 March 2004) *The Stanford Daily*, online at http://daily.stanford.org/article/2004/3/1/resourcesDoNotImpedeDe... <Accessed 04.06.07>.

177 The Legal Janitor, *The Myth of Singapore's Lack of Resources* (9 July 2006) online at http://www.singaporeangle.com/2006/07/myth-of-singapores-lack-o... <Accessed 04.06.07>.

2. Resource-Intensity Theory

Leamer, Maul, Rodriguez and Schott developed this theory to explain why income inequality is higher in Latin America than in East Asia.[178] The theory proposes that permanent agriculture and mineral extraction absorb a natural resource-rich country's scarce savings, and consequently delays the emergence of manufacturing. When manufacturing eventually emerges, it concentrates on moderate to high capital-intensive products. While this is beneficial for competition with the labour-intensive products like those of East Asia, it perpetuates income inequality associated with production of permanent crops, which does not require many educated manpower, and mineral projects which employ very few highly-skilled personnel. Compare this with that of the manufacturing industries in East Asia as in shipbuilding, clothing, electronics and automobile, it is labour-intensive and requires accumulation of human capital. Because manufacturing employs skilled personnel and more people relative to agriculture, income inequality is therefore reduced.[179]

The theory rests on the analysis of the assumption that factor rewards depend upon product mix, which in turn depends on natural resource endowment. Asian countries producing apparel and footwear have one kind of endowment while Latin American countries producing coffee and banana have another. It is assumed that some endowments such as those in Asia attract sectors promoting equality and education while others such as those in Latin America do not.[180]

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[178] Leamer, Maul, Rodriguez and Schott, above n171.
[179] Id., at p.4.
[180] Id., at p.5.

In other words, abundant land, rich natural resources, uneducated workers and scare physical capital characterise Latin American economies. On the other hand, Asia is resource-poor but has abundant and technically skilled human capital. Latin America has relatively more tertiary educated human capital than those that are technically trained for skilled jobs in manufacturing. The income level of the uneducated workers on the one hand compared with those of the tertiary educated gives the obvious result of inequality in income. The natural resource sector employs the tertiary educated labour and in so doing, absorbs national savings. The resource sector on its part creates a very few skilled jobs. This provides a strong disincentive for resource-rich countries to educate their citizens broadly until very late when manufacturing surfaces.[181]

Leamer et al. look at Latin America's product mix by analysing the net exports of countries in Latin America, Asia and the Organization for Economic Cooperation (OECD) countries for the year 1995. They observe that Latin America exchanges natural resources and food for manufactures; Asia trades labour-intensive products for capital-intensive machinery and chemicals, while the OECD countries provide sophisticated manufactures and chemicals in exchange of materials, clothing and toys.

They then look at Latin America's tropical agricultural products categorized into *permanent crops* and *temporary crops*. Permanent crops are crops such as fruits, nuts, coffee and rubber, while temporary crops comprise vegetables and grain. Countries that have land suitable for permanent crops can specialize in producing permanent crops, while those with land suitable for temporary crops can produce those types of crops. However, countries that are not suitable for these types of crops and resource-poor can

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[181] Id., at p.8.

choose to invest in machinery and manufactures. A fourth type of economy may be those which specialise in exporting oil. After analysing these different economies and product mix, Leamer et al. claim that 'tropical agriculture exacerbates income inequality while manufacturing alleviates it...'[182]

Then they proceed to examine whether it is permanent crops that contribute to income inequality in Latin America. That issue is analysed by comparing why softwood forests such as those in Canada, Sweden and Finland are different from banana plantations. They note that softwood forests become final goods unlike tropical permanent crops. First, softwood forests do not require large capital to cultivate, tend, and harvest compared to permanent crops. Second, softwood offer a sequence of small steps towards sophisticated manufacturing, from cutting down the trees, then planning logs, to building furniture, making pulp, manufacturing 'commodity grade' paper, and, finally marketing paper products. The essence of these small steps is that it enables incremental increases in both the capital intensity and also the human capital intensity of the operations. It allows a nation to control an industry from producing primary materials to processing to marketing the finished product. 'By the time a community has progressed to the last of these stages it has the human capital (know-how as well as book-learning) to make Volvos and cell phones. Thus, further capital accumulation beyond the needs in pulp and paper can be diverted easily into non-resource based sophisticated manufacturing.'[183] On the other hand,

> Permanent crops are very different – offering linkages into food processing, but nothing beyond that. Mangoes and dry-farmed rice are perhaps the worst crops in this sense,

[182] Id., at p.13.
[183] Id., at p.15.

> consuming large amounts of the community's capital but offering very little return for the accumulation of human capital, either book knowledge or manufacturing know-how. A community with fully developed banana plantations may find no place at home to invest additional savings, and either capital accumulation will slow or savings will be invested in foreign assets. If it is human capital, then this takes the form of a brain drain with the most talented and most educated workers opting not to work on the plantations but choosing instead to seek better opportunities elsewhere.[184]

The conclusion of this theory is that natural resources, like tropical crops, require less capital intensity and human intensity. Consequently, they fail to provide sufficient economic linkages.[185] More importantly, the emergence of manufacturing is delayed. While manufacturing requires all levels of human capital, from the least educated to the well-educated, the natural resource sector requires a few highly skilled workers and largely uneducated workers especially on the permanent crop plantations. The gap between these two types of workers is revealed by the income inequality. Manufacturing is delayed, and this spirals to affect overall economic performance.[186]

In my view, this study is important because it implicitly supports the proposition that down-stream processing of mineral and hydrocarbon resources would solve the resource curse. Why did Leamer and his learned colleagues fail to come to this conclusion?

3. Predation Theory

Based on the neoclassical economic theory of conflict, Paul Collier proposes a purely economic theory called *predation theory,* which blames the victims of the resource

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[184] Ibid.
[185] Id., at p.16.
[186] Id., at p.20.

curse.[187] He defines *predation* as rebellion, or the use of force to extort goods or money from their lawful owners.[188] His predation theory rests on the assumption that rebels in resource-rich developing countries are not motivated by any just cause. Their only motive is greed for money or wealth, and whether they can sustain themselves financially. Predation theory stands on three legs. First, rebellion is motivated by greed. Second, rebels are motivated by lust for power. And third, rebels are motivated by real or imagined grievances.[189] These three causes are not important so long as what causes conflict provides an avenue for predation. People who believe that rebels have a just cause are simply duped or misinformed: 'they are gulled into believing the discourse which self-interested rebel leaders promote.'[190] Collier concludes that civil wars are caused more by greed for resource wealth than by grievances arising from inequality, ethnic and religious divisions, or political repression and so on. However, resource dependence, low average incomes, slow growth and large diasporas (dispersion of citizenry abroad) are significant and powerful predictors of civil war.[191]

Collier expanded on this theory in a joint study with Hoeffler and applied econometrics to predict the outbreak of civil wars.[192] Collier and Hoeffler used data on 78 civil wars that occurred between 1960 and 1999. Using several proxies for grievances like inequality, political rights, ethnic polarization, religious divisions and so on, they conclude that

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187 Paul Collier, Director, Development Research Group, World Bank, *Economic Causes of Civil Conflict and their Implications for Policy* (Washington D.C.: World Bank, 15 June 2000), online at http://www.worldbank.org/research/conflict/papers/civilconflict.pdf <Accessed 10.09.07>.

188 Id., at p.4.

189 Ibid.

190 Ibid.

191 Id., at p.21.

192 Paul Collier and Anke Hoeffler, *Greed and Grievance in Civil War* (21 October 2001) available at (http://www.worldbank.org/research/conflict/papers/greedgrievance_23oct.pdf <Accessed 10.09.07>. See also http://www.reliefweb.int/library/documents/civilconflict.pdf <Accessed 10.09.07>.

financial reward, or greed for wealth is the most important factor for the cause of civil wars, which ultimately impacts on economic growth and development.[193]

The predation theory has been severely criticized on three main grounds: (1) neoclassical econometric analysis of human behaviours, (2) the use of social features as proxies, and (3) the dynamics of civil wars and the static nature of the models.[194] First, proxies are inadequate reflections of reality. Reality and indicators are distant from one another due to both availability of data and conceptual equivalence of proxies and real things they are to represent. Second, in some cases a proxy may capture the reality, but in other cases a proxy is not the right measure and cannot capture the real trend. Third, econometric models are obviously static while civil war is a process, characterized by different levels of violence. Notwithstanding this, some are continuing to find interesting aspects of the theory and continue to build on it.[195]

4. Resource Wars Theory

The term 'resource wars' first emerged in the United States (US) in the 1980s in reference to the perceived Soviet threats to US interests in oil and minerals in the Middle

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193 Id., at p.17.

194 C. Cramer, 'Homo Economicus Goes to War: Methodological Individualism, Rational Choice and the Political Economy of War' (2002) 30 (11) *World Development* pp.1845-1864.

195 Manuel Travaglianti, 'The Role of the State in the Natural Resources and Civil War Paradigm' (Jean Monnet Working Paper in Comparative and International Politics, University of Catania, October 2006), available online at http://www.fscpo.unict.it/EuroMed/jmwp61.pdf <Accessed 11.09.07>. John C. Anyanwu, 'Economic and Political Causes of Civil Wars in Africa: Some Econometric Results' (2004) 4 *Peace, Conflict and Development*, available online at http://www.peacestudiesjournal.org.uk/docs/CivilWarAfrica.PDF <Accessed 10.09.07>. Simeon Djankov, *The Causes of Civil War* (World Bank Policy Research Paper 4254, June 2007) online at http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2007/06/15/000016406_20070615144341/Rendered/PDF/wps4254.pdf <Accessed 10.09.07>.

East and Africa.[196] This specific use was recently extended by Le Billon as being one of the causes of the resource curse.[197] Le Billon observes:

> Beyond financing war, natural resources have been depicted as an important motive of several wars in the 1990s, from the Iraqi invasion of Kuwaiti oilfields, to civil wars fuelled by diamonds in West Africa. While much attention had been previously devoted to the risk of armed conflicts resulting from the vulnerability of supply of 'strategic resources' for major powers or environmental scarcity in poor countries, most resource-related wars in the 1990s have opposed domestic or regional politico-military entrepreneurs over locally abundant and international valuable resources, such as oil, timber, or diamonds.[198]

Le Billon stresses the link between misgovernance, conflicts, and the historical legacy of social construction and exploitation of natural resources by imperial powers. This legacy is exacerbated by current practices of the global political economy where commodity and financial flows are facilitated without transparency and ethical and moral considerations.[199] In Le Billon's view, 'understanding of the so-called 'resource-curse' and 'resource wars' needs to give consideration to both the forms of power exercised in the 'pre-resource' era, as well as the specific ways in which different resources define specific 'political idioms' and influence political and social outcomes.'[200]

From the global European power expansion since the 16th century to the US invasion of Iraq in 2003, and from the two World Wars to the decolonization movements, and then from the Cold War to the post-Cold War globalization process, Le Billon makes a

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[196] Michael T. Klare, 'Resources Wars' *Harper's* (January 1980) pp.20-23; National Strategic Information Centre white paper cited in Wilson Clark and Jake Page, *Energy, Vulnerability, and War: Alternatives for America*, (1981) p.95.

[197] Philippe Le Billon (ed), *The Geopolitics of Resource Wars: Resource Dependence, Governance and Violence* (2005).

[198] Id, at p.1.

[199] Id., at pp.1-2.

[200] Ibid., p.2.

persuasive case that access to natural resource wealth, particularly *point-source* resources, has always been and will continue to be, one of the most important motives of global political economy.[201] His view suggests that the issue is beyond the resource curse thesis. The critical issue firstly relates to the political economy and governance of resource-dependant countries with respect to translating resource exploitation into political stability and economic development. Secondly, it relates to the scale and number of economic, environmental and socio-cultural conflicts generated by resource exploitation which hurt local populations, business interests, the state, and global environmental and human rights. Thirdly, it relates to the strategic issue that motivates powerful nations like the US to go to war in Iraq to secure oil. Criminals, warlords, political elites, multinational corporations, and nation-states, all covet and compete for strategic resources.[202] These multi-facetted issues are global issues for both developed and underdeveloped nations and corporate interests to address. It is not a local or regional issue of resource-abundant underdeveloped countries.

Le Billion's contribution is very valuable indeed. For those on the political Left, underdevelopment theorists and neo-Marxists, resource wars stem from economic imperialism and the inherent contradictions of global capitalism which maintains the underdeveloped status quo of resource-rich countries.[203] However, those on the political Right argue that it is the presence of rich natural resources that ignite civil wars harming the economy, weakening government, causing political corruption, bringing ethnic

[201] The US invasion of Iraq demonstrates this point.
[202] Id., pp.22-23.
[203] See for example, William K. Tabb, 'Resource Wars' (January 2007) 58 (8) *Monthly Review*, p.35. Michael Watts, 'Empire of Oil' (September 2006) 58 (4) *Monthly Review*, p.1. Harry Magdoff, 'International Economic Distress and the Third World' (October 2006) 58 (5) *Monthly Review*, p.65.

divisions and movements for autonomy.[204] Le Billon's theory seems to bridge the ideological gap by calling for international effort to examine both exogenous and endogenous political economy factors.

IV. SOCIO-CULTURAL CAUSES AND EXPLANATIONS

Much of the literature on the RCT focus on the Dutch disease and the political economy explanations. Socio-cultural explanations are only referred to in passing. For instance, Sachs and Warner, and Ross refer to Bodin's remark in his *Six Books of a Commonwealth* that 'men of a fat and fertile soil, are most commonly effeminate and cowards; whereas contrariwise a barren country makes men temperate by necessity, and by consequence careful, vigilant and industrious.'[205]

Apart from Sachs and Warner, and Ross who point out to cognitive factors in passing, I have not seen any resource curse literature on this topic. However, modernization theorists of the 1940s-1960s did vigorous research on this issue. For example, in his studies on cultural factors in economic growth in Latin America, Cochran notes that the warm tropical or sub-tropical climate that promotes long growing seasons reduces the need for costly housing; accumulation for winter, and the need for steady employment.[206] In such a leisurely environment, sudden influx of goods or cash from resource abundance creates a type of 'cargo-cult' mentality. Kroef provides one of the best descriptions of such mentality from a comparative perspective, comparing Melanesian 'cargo-cult' mentality with that of the Indonesians in the 1950s:

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[204] See Michael Ross, *Natural Resources and Civil War: An Overview*, available online at http://www.unepfi.org/fileadmin/documents/conflict/ross_2003.pdf <Accessed 10.09.07>.

[205] Jean Bodi, *Six Books of a Commonwealth*, edited and translated by M. J. Tooley (New York: Barnes and Noble, 1967) p5, cited in Ross, above n44, at p6. Jean Bodin was a 16th century French philosopher.

[206] Thomas C. Cochran, 'Cultural Factors in Economic Growth' (1960) 20 (4) *The Journal of Economic History* pp515-530, at p529.

> This idea of a "ready made" prosperity that can somehow be obtained independent of economic processes, collective sacrifice, or individual effort is an important deterrent to productivity increase and suggests… a similarity with Messianic "cargo" expectations current in Melanesia. The "cargo" cult is a nativistic movement revolving around the prophesied coming of a vessel manned by the sacred ancestors and carrying a cargo containing the implements and the "mystical" techniques of production of the white man, which have given him superiority over other races. With this cargo the native peoples will rise to prosperity and power and equal, if not surpass, the whites. While there may be cultural differences between these Messianic expectations in Indonesia and Melanesia, both share…this concept of a "packaged" prosperity and technological perfection associated with the Westerner, denoting above all a complete ignorance of the arduous labor, painstaking ingenuity, and the particular historic combination of socio-economic conditions that have made the wealth and technological advancement of the Western world possible.[207]

I agree and disagree. First, let me explain why I agree. This is one of the most important endogenous factors for the resource curse effects in PNG. 'There can be little question that this Messianic orientation, which often achieved a certain blatant crudeness by simply arousing popular greed for material gain' quickly without any effort is so pervasive and ingrained in modern PNG mentality.[208] This 'delusion so deeply implanted [that it is] impossible of eradication overnight.'[209] Corruption, lack of good management, weak bureaucracy, lack of commitment to state institutions, land compensation demands, election contests and political instability, and so on, which are prevalent in PNG, stems from the greed for quick material gain without the arduous labor and painstaking ingenuity Kroef mentions.

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207 Justus M. van der Kroef, 'Economic Development in Indonesia: Some Social and Cultural Impediments' (1956) 4 (2) *Economic Development and Cultural Change* pp116-133, at p118.

208 The words in quotation are from Kroef, ibid. I say this based on my experience and knowledge.

209 Kroef, above n186, at p.118.

While that is true, I disagree because Kroef does not explain why the Westerner works hard while the Melanesian does not. Cochran explains it: the Melanesian depends on his land that adequately sustains his living. He does not need to work hard. The Westerner, on the other hand, works hard because his physical labour is all that he has, which if he does not employ it for wages or business, he would die.

So then, why does the Melanesian seek cargo? That requires understanding the cognitive and cultural values. In Melanesia, the nuances of cultural values such as *wantokism* (one language) and *reciprocity* hold the answer. These two words epitomize *social relationship* and *sharing and caring* above material accumulation. These words denote equity over efficiency. These words mean, if the government represents the people, if politicians are leaders of the electorates they represent, then sharing and distribution of material goods demonstrate their friendship and goodwill, maintaining their wantok identity, asserting their tribal heritage and belonging, their reciprocation of the votes they received. If a person is a transnational corporation, or a foreigner, sharing cargo is an affirmation of friendship and goodwill.

Yet, it is surprising that Ross criticizes the cognitive explanation as 'an appealingly simple way to explain why governments fail to diversity their export bases and fail to maintain fiscal discipline in the face of export instability and the Dutch Disease.'[210] In his view, until economic modeling explicitly test these claims, it is difficult to take cognitive explanations seriously. He comes to this conclusion after outlining the following problems:

[210] Ross, above n23, at 310.

- The cognitive approach transgresses the rationality assumptions that most analysts follow.
- It is usually deployed in an ad hoc manner, rather than as part of an explicit and testable theory, for example, a theory that links variations in state revenues to variations in cognitive skills of policymakers.
- There is little evidence that policymakers collectively fall into wealth-induced stupors. There are some state actors who are well-informed about the perils of resource booms but whose behavior is highly constrained by political pressures and institutions like the World Bank and the International Monetary Fund (IMF).
- If widespread wealth leads to cognitive failure, similar affliction should affect the private sector, but this does not happen. Private sectors in the developing countries react to price shocks far more rationally than their governments.

Two criticisms about Ross's dismissal of the cognitive explanation must be made here. First, it is this scientific attitude of some commentators on economic development policies of developing countries that is the problem. Instead of revising their *rational* assumption as being *irrational*, they cling on to it in the midst of overwhelming evidence negating it. Just as developing countries were originally led to believe in quick wealth and speedy industrialization at the back of resource endowment without the arduous and painstaking ingenuity that Kroef describes, propositions about cultural factors as hindrances to development are dismissed as scientifically untestable. In the case of countries like PNG, understanding and addressing cultural factors is the very first step and the key to development.

Secondly, cognitive and cultural factors as being important preconditions to economic growth in Western Europe are rejected as scientifically irrelevant. However, the literature shows the historical hardships that Europe experienced, the centuries of wars and the consequent social dislocations, the philosophical works in academia to address those problems, then the Industrial Revolution, followed by political revolutions, like the two World Wars, all contributed immensely to shaping and molding Western cultural mindset culminating in the ascendance of self-interest under capitalism. Capitalism was a necessary alternative to the chaotic medieval order. As duGay explains:

> [The] commercially directed forms of 'rational' self-interest were viewed, in context, as possible solutions to the disastrous conflicts besetting early modern Europe, particularly those associated with religious war and aristocratic adventurism. From this perspective, the focus on self-interest governed conduct, commercial or otherwise, was a product of an urgent quest 'for a new way of avoiding society's ruin, permanently threatening at the time because of precarious arrangements for internal and external order'…For its early modern advocates, 'self-interested' conduct appeared as a potential cultural counterweight to the menace posed by the world of the "full human personality", replete with its destructive passions. From the perspective of the present, such a belief in the efficacy of 'self-interest' can appear remarkably naïve or just plain monstrous. The ravages of contemporary economic globalization, for instance, are regularly held up as exemplars of the full horrors of unbridled self-interest. And yet, if we exercise our historical imaginations just a little, we might also wonder at contemporary critics' forgetfulness of the dire consequences of a time when social and political existence was dominated by rival religious zealotries and the search for 'glory'.[211]

Commenting on Hirschman's exploration of how and why 17th and 18th century Western philosophers promoted the idea of self-interest and capitalism at a time when money-making was seen as anti-social, duGay continues:[212]:

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[211] Paul duGay, 'Which is the 'Self' in 'Self-Interest'?' (2005) *The Sociological Review* 391, at p395.
[212] Albert Hirschman, *The Passions and Interests* (1977).

> [The 17th and 18th century thinkers], many of whom were personally antithetical to money making and commerce, came to look favourably upon commercial self-interest… because they saw it as a relatively peaceful and harmless alternative to the violent passions that had fuelled the European wars of religion and inspired military and aristocratic adventurism. Weary of the destruction caused by unbridled passions, and bent on reform, a number of these thinkers were hopeful that the 'mild' passion for money-making and calculation, 'although admittedly ignoble and uncouth, could defeat and bury the violent passions that so ruinously stoked the endless cycles of civil butchery'...[213]

Since self-interest and money-making are cognitive, rather than scientific, Ross's dismissal of cognitive factors as unscientific, and therefore, untestable hypothesis, misses one of the real cause of the resource curse.

Ross's fourth argument is cyclical, and negates the premises of the cognitive argument. Private sectors work hard to accumulate wealth, whereas the state does not. The cultural and cognitive force of self-interest is a personality construct. The state, being impersonal, does not on its own possess the requisite self-interest. Only state agents possess self-interests. Personal self-interests of state agents may be antithetical and detrimental to the welfare of the state. That should explain why states do not perform well compared to the private sector.

In PNG, the *Messianic mentality* is evident among most politicians, state bureaucrats and their supporters, as well as business owners from resource project areas.[214] Nurske and Watkins are therefore correct in observing that resource rents lead to 'get-rich-quick

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[213] DuGay, above n190, at p395. DuGay cites the final sentence in inverted commas from S. Holmes, *Passions and Constraint* (1995) p.54.

[214] This is based on my work experience in the natural resource industry in PNG and as First Secretary of a government minister in the PNG government, as well as general knowledge.

mentality' among businessmen and a 'boom-and-bust' psychology among policymakers marked by bouts of excessive optimism and frantic retrenchments.[215] Wallich and Levin describe the same mindset in sugar-exporting states as being distorted by a 'sugar mentality' which leads to lax economic planning and insufficient diversification.[216]

Yet, the resource curse theorists miss this important cause. For any future study, the question needs to be focused not on non-cognitive institutions that cannot act and make decisions on their own, but on human agents who act through institutions to bring about outcomes that produce the curse effects or progress. If research is directed in this way, then cognitive factors should take centre stage instead of institutions. Seen from this standpoint, the human capital theory is correct to point out that human education is more important than institutions in understanding the curse.

V. ANALYSIS

From this lengthy survey of the resource curse literature, I do not find any useful explanation from the *economic explanations* that is relevant to the PNG experience. From the political *economy explanations*, corruption and rent-seeking are endemic in PNG, but apart from blaming politicians, no curse literature explains the cognitive reasons that cause state-actors to engage in corruption and rent-seeking behaviours. Even if there were explanations, in my view corruption and rent-seeking are practiced the world over, and they involve two parties, internal-internal or internal-external actors competing for natural resource rents, so blaming internal actors alone as the curse

[215] Ragnar Nurse, 'Trade Fluctuations and Buffer Policies of Low-Income Countries' (1958) 2 *Kyklos* p.11; Melville H. Watkins, 'A Staple Theory of Economic Growth' (1955) *Journal of Political Economy* p.63.

[216] Henry C. Wallich, *Monetary Problems of an Export Economy* (1960); Jonathan V. Levin, *The Export Economies: Their Pattern of Development in Historical Perspective* (1960).

theorists seem to do, is not helpful in understanding the reality of underdevelopment in PNG. In some instances, corruption in PNG functions as 'economic stimulus packages' in the industrialised world by providing money to cashless people in the rural areas, which ultimately stimulates the rural economy.[217]

Of the institutional explanations, the settlement mortality theory is relevant. It correctly locates the origin of underdevelopment in colonialism, imperialism, neocolonialism and globalization. The structured contingency theory is also helpful but not very clear. The resource intensity theory is useful in pointing out the need to go down-stream processing. The resource wars theory is valuable in transcending ideological barriers to advocate the need to address the RCT by examining both exogenous and endogenous causes from all ideological positions.

Next, the human capital theory is relevant. In the case of PNG, colonial education policy was designed to keep Papua New Guineans uneducated or educated very gradually.[218] This colonial legacy explains why Papua New Guineans do not have the knowledge, technology or skills to extract mineral and hydrocarbon resources without relying on foreign multinational corporations today. In this respect, the experience of the United States that Wright and Czelusta present above is useful. It is critical that the post-colonial government emphasize and prioritize education and human development instead of natural resources development.

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[217] Some instances of bribery and cash handouts to political supporters, although illegal, does stimulate rural areas by generating cash circulation; for instance, based on my experience in the Southern Highlands Province under the late Dick Mune and his successor the Hami Yawari regimes between 1992 and 2007, corrupt money circulating within the villages caused increased economic activities.

[218] James Griffin, Hank Nelson and Stewart Firth, *Papua New Guinea: A Political History* (1979) p.29. For a good summary of the prerequisite institutions for independence, see Edward P. Wolfers, 'State of the Nation' in J. W. Hudson (ed.), *Australia's New Guinea Question* (1975) 1, at p.19.

Finally, the entire legal explanation is absolutely relevant. These legal explanations leave no doubt that lack of domestic ownership of mineral and hydrocarbon extraction and deprivation of customary property rights in these resources cause the resource curse. Rent-seeking and corruption would be eliminated, it is argued, if ownership of these resources were left in the customary owners. Therefore, to avoid the resource curse, a resource-rich developing country like PNG must restore and respect traditional property rights in natural resources, and promote local entrepreneurs to own and extract these resources, and undertake down-streaming processing as well.

VI. CONCLUSION

Too much theorizing among orthodox development theorists complicates and confuses a rather simple problem. The question is: Who benefits and who loses? It is my argument that the rich and powerful economic North collaborates with the ruling elites of the neocolonial economic South to share the oil and mineral bonanza. Yet the orthodox explanations focus only on internal factors that blame the Southern elite beneficiaries and remain silent on the role of their Northern partners. This thesis argues that the economic North benefits through:

- institutions established during the colonial era and maintained through neocolonialism as the settlement mortality theory demonstrates;
- international institutions and organizations (IMF, World Bank, WTO) that fund and influence politics and policy-making;
- employment of ideas and concepts that are difficult to understand, many of which are irrelevant to the real conditions of developing countries, but nevertheless produced for their consumption;

- powerful corporations that wield enormous economic power to influence laws and policy decisions in their favour;
- economic power channeled through trade and aid programs that maintain external influence in internal politics and policy-making; and
- military power that threatens to intervene if access to minerals, and especially oil, is denied.

Instead of looking at these relational political economy factors – both exogenous and endogenous factors - in a capitalist world inhabited by human beings competing for minerals, hydrocarbon, and other natural resources, much ink has been spilt to describe underdevelopment or capitalist exploitation as a curse of natural resources abundance.

CHAPTER FOUR

UNDERDEVELOPMENT OF DEVELOPMENT EXPLANATIONS

Fundamental progress in economics has to do with the restudy of basic ideas. It is through the reexamination as well as reinterpretation of basic ideas that we can fully appreciate the past and become aware of possibilities of and hindrances to advancing.'[1]

INTRODUCTION

Before the emergence of the resource curse thesis (RCT) in the 1990s, underdevelopment economics in the 1950s-1970s in critiquing *development theory* (which is used interchangeably here with *modernisation theory*) posited that resource-rich developing countries are (and will be) *cursed*. Instead of using the word *curse*, however, the phrase *underdevelopment of development*, or simply *underdevelopment*, was employed. Four causes and explanations were advanced by underdevelopment economics to support the underdevelopment thesis. This chapter examines these four causes and explanations in order to compare and contrast them with the causes and explanations of the RCT in chapter three and determine which of these two competing explanations are relevant to the experience of Papua New Guinea (PNG) and similar developing countries.

The four underdevelopment causes and explanations are examined under *structuralist* theory in section II, *dependency* theory in section III, *world systems* theory in section IV, and *imperialism* and *monopoly capitalism* theories in section V. The last section provides a conclusion. The first section provides an overview of underdevelopment economics.

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[1] Wei-Bin Zang, *Economic Growth Theory: Capital, Knowledge and Economic Structures* (2005) p.73.

I. OVERVIEW OF UNDERDEVELOPMENT EXPLANATIONS

In the 1950s-1970s, some development economists especially from Latin America like Raul Prebisch (1901-1986), Osvaldo Sunkel, Theotonio Dos Santos, and others from elsewhere like Hans Wolfgang Singer (1910-2006), Gunnar Myrdal (1898-1987), Paul A. Baran (1909-1964), Paul M. Sweezy (1910-2004), Andre Gunder Frank (1929-2005) Immanuel Wallerstein and Samir Amin critiqued the assumption of development theory that resource-rich developing countries would modernize rapidly through resource-based industrialization. These critiques form the core of underdevelopment economics, comprising *structuralism*, *dependency*, and *world-systems* theories. *Structuralist* theory provided the first neoclassical critique of development discourse, followed by neo-Marxist *dependency* and the *world systems* theories. These theories posit that developing countries will not be 'developed' but 'underdeveloped' even if they are resource-rich. This is not to say that developing countries will be *undeveloped*, which is 'a condition in which resources are not being used,' but *underdeveloped*, which is 'a situation in which resources are being actively used, but used in a way which benefits dominant states and not the poorer states in which the resources are found.'[2]

Underdevelopment theories are based on historical interpretation of the political economy conditions of developing countries.[3] In that sense, they are similar to the settlement mortality theory of the RCT. These theories hold that international political economy relations between the industrialized powers and the Third World today came about through the historical processes of colonialism and imperialism, and decolonization and

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[2] Vincent Ferraro, *Dependency Theory: An Introduction*, (Mount Holyoke College, MA: July 1996), online at http://www.mtholyoke.edu/acad/intrel/depend.htm. <Accessed 04.07.08>.

[3] See Andre Gunder Frank, 'The Development of Underdevelopment,' in James D. Cockcroft, Andre Gunder Frank, and Dale Johnson (eds), *Dependence and Underdevelopment* (1972).

neocolonialism, which is now deepened by globalization.[4] Through this historical approach, underdevelopment theorists posit that colonialism and the decolonization process put in place institutional *structures* that allow a *dependent/dominant* relationship in the world capitalist system and fosters *unequal exchange* in favour of the dominant power resulting in *underdevelopment*.[5] Andre Gunder Frank puts it this way:

> [H]istorical research demonstrates that contemporary underdevelopment is in large part the historical product of past and continuing economic and other relations between the satellite underdeveloped and the now developed metropolitan countries. Furthermore, these relations are an essential part of the capitalist system on a world scale as a whole.[6]

Modernisation theory viewed that the Third World was underdeveloped because of the retarded and incomplete formation of its capitalist institutions, so they recommended cultural change and capital formation through foreign direct investment (FDI) and deliberate government planning to stimulate development and economic growth. It assumed the existence of dual economies in these 'backward' regions and sought to promote economic growth based on capital accumulation from *savings* through the exploitation of natural resources. Underdevelopment theories, on the other hand, are premised on the following assumptions:

- Structuralist theory assumes that existing domestic and international political economic structures are the immediate cause of underdevelopment, and

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[4] Vandana Shiva, *Biopiracy: The Plunder of Nature and Knowledge* (1998) p.105. On globalization see Anthony Giddens, *The Consequences of Modernity* (1990) p.64; Ulrich Beck, *What is Globalization?* (2000) p.11.

[5] K. S. Krishnaswamy, 'Privatization, Globalization and Swadeshi: Which Way Lies the Solution?' in Swamy, K.S. Narayana and T. Krishna Murthy (eds), *Sustainable Development: The Ghandhian Perspectives* (1993) pp.91-118.

[6] Frank, above n3, at p.3.

recommends structural changes through domestic manufacturing, self-sufficiency and other policies to assert economic independence.[7]

- Dependency theory agrees with structuralism but adds that since the wealthy nations of the world need peripheral countries to remain wealthy, the economies of the peripheral countries are made dependent on the rich countries. The obstacle to 'national development' is caused by 'cultural dependence of the elite' on the 'colonizer' and the intrusion of transnational corporations (TNCs) in the peripheral economy.[8] Political revolution to severe the colonial and neocolonial connections is required to break free from this dependence.[9]
- World systems theory posits that because the world economy is a single world capitalist system (not dual economies as assumed by modernization theory), even if industrial growth did occur in the peripheral countries, their economies remain dependent on the capitalist 'centres' for access to markets, finance and technology. Growth in the periphery is 'developed' by the world capitalist system so that the peripheral economy remains in a state of 'under-development'.[10]

Underdevelopment theorists see the origin of accumulation as arising from *internal* and *external* exploitation.[11] Internal exploitation arises through the use of state power to enclose and monopolize wealth-producing resources like land and minerals, and wealth-producing processes like knowledge, technology, and skills by those who wield power.[12]

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7 See Mathias Vernengo, *Dependency Theory* (University of Utah: undated) online at http://www.econ.utah.edu/~vernengo/papers/princeton.pdf. <Accessed 20.01.09>.

8 See materials on dependency theory at http://science.jrank.org/pages/8975/Dependency-Radical-Dependency-Theorists.html. <Accessed 20.11.08>.

9 Frank led this view: see above n3.

10 See Robert J.S. Ross and Kent C. Trachte, *Global Capitalism: The New Leviathan* (1990) p.52.

11 Karl Marx, *Capital,* (Friedrich Engels ed, 1952 ed) pp.279-372. Gerald Allan Cohen, *Self-Ownership, Freedom and Equality* (1995) pp.118-119; Jon Elster, *An Introduction to Karl Marx* (1986) ch.5.

12 The Enclosure Movement and the reservation of Crown minerals provide good examples. In Great Britain, privatization of land started with the Statute of Merton in 1235. Between 1760 and 1844

External exploitation commenced with imperialism and colonialism, and continues today through neocolonialism and globalization.[13]

> Colonial conquest gained title to lands and the wealth it produced. The conquerors were 'entitled' to do what they wished with their new property and, of course, they wished to transfer all wealth to themselves. Monopolization of natural wealth and the wealth-producing-process through exclusive titles were specifically designed to claim the wealth produced.[14]

Development theory assumed that political independence would put an end to this exploitative colonial program as newly independent nation-states begin to assert permanent sovereignty over their natural resources.[15] However, according to the theory of *neocolonialism* political independence did not severe the umbilical cords of 'exploitative capitalism'.[16] Neocolonialism views that since capital, technology, skills and knowledge to extract natural resources are *concentrated* in TNCs from the industrialized *centre*, these corporations exercise monopoly over production as well as

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almost 4,000 enclosure laws were passed, effectively legitimizing common land stolen through private enclosure. See Pert Kropotkin, *Mutual Aid* (no date) p.225. At the turn of the 20th century, about ten thousand people drawn almost entirely from a core of 1,500 families owned great estates and houses and works of art, but above all, they owned well over ninety percent of Britain. See Lewis Mumford, *The City in History* (1961) p.264. Angela Lambert, *Unquiet Souls* (1984) p.6. To erase from memory the fact that land was commonly owned, universities and churches taught and continue to teach the virtues of private property as an important institution of liberal democracy. See Kropotkin, ibid., at p.226. See also George Renard, *Guilds in the Middle Ages* (1968) chs.7-8. Legislation in many developing countries like Papua New Guinea reserve minerals and petroleum in the State. The State then transfers its mineral and petroleum rights to TNCs who hold exclusive rights over exploration and production. The same enclosure principles apply through the licensing regime.

13 See Thomas Sebastian, *Globalization and Uneven Development: Neocolonialism, Multinational Corporations, Space and Society* (2007); Joseph I. Fernando, *Towards a Critique of Globalization* (August 2008), a paper online at http://www.globethics.net/c/document_library/get_file?p_l_id=24630&folderId=55052&name=DLFE-87.pdf. <Accessed 21.01.09>.

14 J. W. Smith, *Economic Democracy: The Political Struggles of the Twenty-first Century* (4th ed, 2005) p.247.

15 See Jorge Larrain, *Theories of Development* (1989) chapters 4 & 5.

16 Kwame Nkrumah, *Neo-colonialism: The Last Stage of Imperialism* (1965) p.xi. Nkumah, Ghana's first president after independence is attributed to have first coined the term 'neocolonialism'. See also Bill Ashcroft, Gareth Griffiths and Helen Tiffin, *Key Concepts in Post-Colonial Studies* (1998), and Robert Young, *Postcolonialism: An Historical Introduction* (2001).

prices on the sale of natural resources.[17] Some observers describe the new form of accumulation through neocolonialism as *plunder by raid* and *plunder by trade*[18] or simply *accumulation by dispossession*.[19]

The intellectual sources of underdevelopment theory are various, from Alexander Hamilton (1755-1804) and Friedrich List (1789-1846) to Henry George (1839-1897), and from Karl Marx (1818-1883) and Friedrich Engels (1820-1895) to Rudolf Hilferding (1877-1941) and Vladimir Lenin to (1870-1924) to Paul A. Baran (above).[20]

II. STRUCTURAL CAUSES AND EXPLANATIONS

The theory of *structuralism* emerged in Latin America to define the role of the *dominance-dependence* structure in causing underdevelopment. Among others, structuralist discourse primarily emerged from the works of the United Nations (UN)

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17 Stephen J. Kobrin, ''Our Resistance is as Global as Your Oppression': Multinational Corporations, the Protest Movement and the Future of Global Governance' (Paper presented at the International Studies Association, Chicago, February 2001). Available online at http://www-management.wharton.upenn.edu/kobrin/Research/AntiMNE%20sent.pdf. <Accessed 22.11.08>. Anna Manzo, 'Rethinking Colonialism: For the Third World, Economic Globalization is More of the Same' (November 1998) *Toward Freedom Magazine*. Available online at http://www.thirdworldtraveler.com/New_World_Order/RethinkingColonialism_TF.html. <Accessed 22.11.08>. Martin Broughton, Chairman of the British American Tobacco, in his opening remarks to a panel discussion on 'The New Competitive Stakes for Global Companies' at the International Chamber of Commerce 33rd World Congress in Budapest, Hungry, on 5 May 2000, on the topic 'Doing Business in a Borderless World', acknowledged globalization led by multinational corporations as 'new colonialism'. His remark is online at http://www.bat.com/group/sites/uk__3mnfen.nsf/vwPagesWebLive/DO72FF45/$FILE/medMD5WGNMT.pdf?openelement. <Accessed 22.11.08>.

18 See J.W. Smith, *From Plunder by Raids to Plunder by Trade* (Institute for Economic Democracy at http://www.ied.info/articles/global-warming-poverty-elimination-no-more-war-activists-2/from-plunder-by-raids-to-plunder-by-trade. <Accessed 21.11.08>. See also Adel Samara, 'Privatization or Class Destruction and Social Disintegration' (April 2003) 3 (236) *Kana'an Electronic Bulletin*, online at http://www.kanaanonline.org/articles/00236.pdf. <Accessed 22.11.08>. Samara talks about the plunder of Iraq's wealth by the USA and its allies.

19 David Harvey, *The New Imperialism* (2003).

20 M. Patrica Connolly, Tania Murray Li, Martha McDonald, and Jane L. Partpart, 'Feminism and Development: Theoretical Perspectives', in Jane L. Partpart, M. Patricia Connolly, and V. Eudine Barriteau (eds), *Theoretical Perspectives on Gender and Development* (2000) ch.3 provide comparative view on the contributions these and other writers made in development economics. Frederick Engels, *The Origin of the Family, Private Property and State*, with Introduction and notes by Eleanor Burke Leacock (first published in English, 1942, reprinted 2001) traces the origin of internal sources of accumulation; Henry George, *Progress and Poverty* (1st published 1894, 2006 ed).

Economic Commission for Latin America (ECLA) headed by Raul Prebisch as its executive secretary.[21] Prebisch, an Argentinean economist trained in neo-classical economics, like John Maynard Keynes, became disillusioned with the inability of neoclassical economics to explain the economic problems created by the Depression of 1929, disruptions caused to the international economic systems by World War II, and the real economic conditions in Latin America.[22] Based on the neoclassical theory of free trade and *laissez-faire* capitalism development theory assumed that the terms of trade of primary commodities would be improving over time, which would help developing countries to accumulate capital.[23] In the 1950s, Prebisch and Singer independently challenged this assumption.[24] The Prebisch-Singer thesis argued that primary commodity exporting countries would instead face a decline over time.[25] The essence of their argument was that, contrary to modernisation discourse, resource-based growth alone would be ineffective because the world prices of primary exports relative to manufactures show a deep tendency towards secular decline.[26] They further argued that the world

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[21] Katie Willis, *Theories and Practices of Development* (2005) p.66. On structural theory, see Claude Levi-Strauss, *The Elementary Structures of Kinship* (1945); ------ *Structural Anthropology* (1955); Terence Hawkes, *Structuralism and Semiotics* (1977). See also John Lye, *Some Elements of Structuralism and Its Application to Literary Theory*, at http://www.brocku.ca/english/courses/4F70/struct.html <Accessed 11 July 2007>; Mark Glazer, *Structuralism*, online at http://www.panam.edu/faculty/mglazer/Theory/structuralism.htm. <Accessed 11 July 2007>; and Janelle Meyer, *Structuralism*, at http://www.as.ua.edu/ant/Faculty/murphy/struct.htm <Accessed 11 July 2007>.

[22] Diana Hunt, *Economic Theories of Development: An Analysis of Competing Paradigm* (1989) pp.40-49.

[23] Dimitris Diakosavvas and Pasquale L. Scandizzo, 'Trends in the Terms of Trade of Primary Commodities, 1900-1982: The Controversy and Its Origins' (1991) 39 (2) *Economic Development and Cultural Change* pp.231-264. Diakosavvas and Scandizzo provide a list of authors and the studies for and against this issue and those who remain neutral dating back to the classical political economy era of David Ricardo and his doctrine of comparative advantage. See also Charles R. Whittlessey, 'Foreign Investment and the Terms of Trade' (1932) 46 (3) *The Quarterly Journal of Economics*, pp.444-464; H. Myint, 'The Gains from International Trade and the Backward Countries' (1954-1955) 22 (2) *The Review of Economic Studies* pp.129-142; and P.J. Drake, 'Natural Resources Versus Foreign Borrowing in Economic Development' (1972) 82 (327) *The Economic Journal* pp.951-962.

[24] Diakosavvas and Scandizzo, ibid.

[25] Raul Prebisch, *The Economic Development of Latin America and Its Principal Problems* (1950); Hans W. Singer, 'The Distribution of Gains Between Investing and Borrowing Countries' (1940) 2 *American Economic Review* p.40.

[26] See S. Charusheela, *Structuralism and Individualism in Economic Analysis: The 'Contractionary Devaluation Debate' in Development Economics* (2005) p.75.

demand for manufactured products would grow faster than the demand for primary products.[27]

These arguments had to be anchored within a theoretical context. So, the structuralist borrowed ideas from neo-Marxists like Paul Baran, among others. Baran had argued that the removal of 'economic surplus' previously accumulated and currently generated in the periphery could cause a serious setback to the primary accumulation of capital in the periphery.[28] Baran was addressing the question: 'why is it that in backward capitalist countries there has been no advance along the lines of capitalist development that are familiar from the history of other capitalist countries, and why is it that forward movement there has been either slow or altogether absent?'[29] Baran answered that the nature of Western European development itself and the effects of Western European capitalist penetration of the periphery explain this result. Capitalist penetration outside of Western Europe took the form of (1) 'settler' colonies like North America and Australia, which led to their autonomous development, and (2) 'extractive' colonies like those in Latin America, Africa, and Asia, where there were larger, more populous, and often more developed indigenous cultures, which prevented settlement. In the latter the colonizers were 'engaged in outright plunder or in plunder thinly veiled as trade, seizing and removing tremendous wealth from the places of their penetrations,' leading to intercontinental resource flows that were detrimental to the economy of the 'extractive' colonies.[30] The economies of these 'donor' countries fed the industrial revolution in Europe, while they remained being systematically underdeveloped.[31]

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27 Sylvia B. Guillermo Peon, 'The Terms of Trade Controversy' (2004) *Foro Economia* p.121, at p.126. Online at http://www.aportes.buap.mx/27fo2.pdf <Accessed 10.08.07>.

28 Paul A. Baran, *The Political Economy of Growth* (1957).

29 Id., at pp.280-281.

30 Ibid. See also H. W. Arndt, *Economic Development* (1987) pp.117-118.

31 Baran, ibid.

The theoretical foundation of structuralism also came from the works of the French Marxist philosopher Louise Althusser (1918-1990) who analysed the whole global social structure as consisting of economics, political, ideological and theoretical 'instances' among which the economic is the determinant, while others have *relative* autonomy.[32] This global social structure or social formation is characterised by a *structure of dominance* between the *principal* and the *secondary*, which are *mutually dependent*.[33] There exists a *contradiction* between the two: dominant or principal contradiction, and secondary contradiction. The *dominant contradiction* cannot be a dominant one if there is no *subordinate contradiction*, and vice versa. The contradiction itself reflects the organic relation it has with others in the structure in dominance of the complex whole.[34] The dominant contradiction and the subordinate contradiction, by necessity of the contradiction itself, are of *unequal force*. Without this inequality the relation between dominant and dependent would be otiose.

The economic is the determinant 'instance' as well as the *determinant contradiction* in the *dominant-subordinate* relation because of the *force of production* and the *relation of production*.[35] Although the economic may not be dominant and determinant at times, ultimately it determines the very structural relation between the dominant and the subordinate.[36] In other words: 'Economic relations, centrally between those owners and direct producers, are always determinant (in the last instance) but…this determination by the economic structure takes the rather indirect form of assigning to the other, non-

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32 Louis Althusser, *Reading Capital* (Ben Brewster trans, 1970 ed) p.182.

33 Francoise Dosse, *History of Structuralism* (Deborah Glassman trans, 1998 ed) ch.8.

34 Louis Althusser, *For Marx* (Ben Brewster trans, 1969 ed) p.208.

35 Yin-Bin Ning, *Althusser's Structuralist Model* at http://sex.ncu.edu.tw/members/ning/publication/academic/structuralist_model.pdf <Accessed 26 July 2007>.

36 Ning, ibid. See also Richard Peet & Elaine Hartwick, *Theories of Development* (1999) p.103.

economic levels, their place in a hierarchy of dominance with respect to one another, and the kind of articulation between them.'[37]

Informed by this, the structuralists argued that colonial structures such as colonial enterprises and international trade had not been useful for economic development as modernisation theory has led us to believe.[38] Because of deep structures of imperialism and capitalism, colonialism had imposed superstructures of economic institutions, and socio-political structures that oriented towards the First World.

> With distorted national institutions and economic structures, Third World countries were defenceless to the distortionary development implied by trade-induced interaction with heavily-financed First World monopolistic capitalism. As a result, Third World countries… were being dragged into a state of "dependency" upon the First World, becoming the producers of raw material for the First World manufacturing development – a "center-periphery" relationship.[39]

Accordingly, capital cannot be formed because the existing structures of underdeveloped economies have been historically determined by the manner in which these economies have become incorporated into the international economy.[40] Colonialism had created a dual economic structure basically comprising a modern sector oriented to the production

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[37] See Ted Benton, *The Rise and Fall of Structural Marxism: Althusser and His Influence* (1984) p.72.

[38] Andre` Gunder Frank, *Capitalism and Underdevelopment in Latin America: Historical Studies of Chile and Brazil* (1967); -----, *Latin America: Underdevelopment or Revolution: Essays on the Development of Underdevelopment and the Immediate Enemy* (1969);

[39] An article entitled *Raul Prebisch*, online at http://cepa.newschool.edu/het/profiles/sweezy.htm <Accessed 11 July 2007>.

[40] See Ronald Chilcote, 'Dependency: A Critical Synthesis of the Literature' (1974) 1 (1) *Latin American Perspectives* pp.4-29.

of primary products for export, which are bought cheaply, and a subsistence sector from which cheap labour is supplied to subsidize the capitalist sector.[41]

Structuralist theory did not disagree with modernization theory that 'backward' developing countries need to modernize. Rather, it only pointed out that because of the structural unfairness, modernization led by foreign direct investment (FDI) was not possible without restructuring the political economy status quo that favoured the rich developed nations. What should the developing countries do then? The solution was to pursue economic independence through a combination of policies that promoted import-substitution industrialization (ISI) and protection of infant industries. Industrialization was advocated to solve the worsening balance of payment crises, war-time interruptions in international trade, and the continuing shortages of manufactured imports.[42] The structuralists relied on the ideas of the German economist Friedrich List (1789-1846) to advocate state-assisted industrialization through the control and management of imports using tariffs and duties.[43] List's state-assisted industrialization policy was also the

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41 William Cole and Richard Sanders, 'A Modified Dualism Model for Latin American Economies' (1972) 6 (January) *Journal of Developing Areas* pp.185-198; Juan Corradi, 'Dependency and Foreign Domination in the Third World' (1972) 4 (Spring) *The Review of Radical Economics* pp.1-125; H. W. Singer, 'Dualism Revisited: A New Approach to the Problems of the Dual Society in Developing Countries' (1970) 7 (October) *Journal of Development Studies* pp.60-75; Mitchell Seligson, 'The 'Dual Society' Thesis in Latin America: A Re-examination of the Costa Rican Case' (1972) LI (September) *Social Forces* pp.91-98. See Hunt, above n22, at p.50.

42 John Rapley, *Understanding Development: Theory and Practice in the Third World* (2nd ed, 2002) p.14.

43 Willis, above n21 at p.66. List is the 'godfather' of all state-centred approaches to political economy, and his contribution in international political economy is well-recognized, but his thesis that governments play crucial role in economic development is not popular. List emphasizes that 'power' and 'politics' are integral part of political economy, and the assumption that economics is an abstract science is a folly. List emphasizes the dependence of the international economy on the power and strategies among nation-states. See Eckard Bolsinger, 'The Foundation of Mercantile Realism: Friedrich List and the Theory of International Political Economy', a paper presented at the 54th Political Studies Association Annual Conference 5-8 April 2004, University of Lincoln, online at http://www.psa.ac.uk/journals/pdf/5/2004/Bolsinger.pdf. <Accessed 20.11.08>. List's book, T*he National System of Political Economy*, first published 1841, translated by Sampson S. Lloyd, with an Introduction by J. Shiled Nicolson, (1909), is available online at http://oll.libertyfund.org/index.php?option=com_staticxt&staticfile=show.php%3Ftitle=315&Itemid=27. <Accessed 24.11.08>.

policies followed by the now developed countries like Great Britain, Germany, France, Japan and the United States of America (USA) when they were at a comparable stage of development.[44]

Industrialization was not only to substitute the local demand for manufactured products imported from the center, but also for export in addition to the export of primary commodities, thereby expanding and diversifying the export base. As Prebisch puts it, the declining terms of trade between manufactured and primary products had to be narrowed '*by means of import substitution, or industrial exports would have to be added to the primary ones, or a combination of the two.*'[45] Singer adds: 'In the conditions of the 1950's and 1960's a tendency to give preference to import substitution was natural since (a) developing countries had to build up a domestic production capacity in order to export manufactures and (b) they would find it initially easier to produce for an existing and known domestic market than for an unknown global market.'[46]

Revenue volatility is the second leg of the argument from the Prebisch-Singer thesis. Revenue volatility primarily reflects a narrow tax base and an undiversified economy.[47] Natural resource exporting countries face this problem. Since international commodity prices sharply fluctuate, developing countries that rely on resource exports would make

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[44] For details see Ha-Joon Chang, *Kicking Away the Ladder: Development Strategy in Historical Perspective* (2003).

[45] Raul Prebisch, 'International Trade and Payments in an Era of Coexistence: Commercial Policy in the Underdeveloped Countries' (1959) 49 (2) *The American Economic Review* p.251, at p.254. Italics supplied for emphasis.

[46] Hans W. Singer, 'The Terms of Trade Fifty Years Later – Convergence and Divergence' (1996) 27 (4) *South Letter* p. 30, available online at http://www.southcentre.org/southletter/s130/South%20Letter%2030trans-12.htm <Accessed 10.08.07>.

[47] See for example, Catriona Purfield, 'Managing Revenue Volatility in a Small Island Economy: The Case of Kiribati' (IMF Working Paper No WP/05/154, Washington D.C., 2005).

government revenue and foreign exchange supplies unreliable.[48] Singer argued in 1958 that:

> The case for stabilization of terms of trade – direct stabilization through price manipulation – has, it seems to me, nothing to do with the existence of their secular trends but a great deal to do with their large and extremely damaging cyclical and short-term fluctuations. Long-run trends are if anything an argument against stabilization of terms of trade, as I believe most sensible people agree. But the violent cyclical and short-term fluctuations certainly add to the underlying difficulty discerned by Prebisch and others.[49]

Such unreliability is risky and can discourage foreign investment. Failure to attract foreign investment can cause stagnation in the overall economic performance of an underdeveloped country. Therefore, Nurske advises: 'Foreign investment in extractive industries working for export is not to be despised, since it usually carries with it various direct and indirect benefits to the country where it is made.'[50] However, some have argued against this proposition by pointing out that because of the enclave nature of the extractive industries, foreign investment in this sector would fail to generate any *forward* and *backward linkages* in other sectors of the economy.[51]

Some resource curse theorists disagree with the Prebisch-Singer thesis because they cannot understand why a slow decline in commodity prices would explain economic deterioration. For example, Paul Stevens argues that 'it is difficult to see why a slow

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[48] Ragnar Nurske, 'Trade Fluctuations and Buffer Policies of Low-Income Countries' (1958) 2 *Kyklos* p.11; Jonathan V. Levin, *The Export Economies: Their Pattern of Development in Historical Perspective* (1960).

[49] H. W. Singer, 'Terms of Trade and Economic Development: Comment' (1958) 40 (1, Part 2) *The Review of Economics and Statistics* p.85.

[50] Ragnar Nurske, 'Growth in Underdeveloped Countries: Some International Aspects of the Problem of Economic Development' (1952) 42 (2) *The American Economic Review* p.571.

[51] Albert O. Hirschman, *The Strategy of Economic Development* (1958); Robert E. Baldwin, *Economic Development and Export Growth: A Study of Rhodesia, 1920-1960* (1966).

decline in prices would explain the sort of deterioration in economic performance associated with "resource curse". Economies constantly face changing relative prices. If they take place gradually, economies might be expected to adjust unless other factors are at work.'[52]

It is true that prices have fluctuated and there are other factors at work. The price of oil, for instance, has fluctuated but mostly increased over the years instead of constantly declining. As Adelman notes, a grade of oil known as Arab Light was selling at US$3.75 per barrel in 1970, $23.00 in 1978, $54.00 in 1980, $16.00 in 1986, and $13.00 by the end of June 1990.[53] After 11 September 2001, crude oil prices have skyrocketed from an average of US$23 in June 2001 to a peak average of US$58.30 by June 2006 before settling at an average of US$55.32 by June 2007.[54] By 9 May 2008, a barrel was selling at US$126.00.[55] These price increases appear to negate the Prebisch-Singer thesis. That is why, as Steven implies, the curse theorists seek other factors to explain the resource curse. However, this thesis argues that price volatility is only one aspect of the two-pronged Prebisch-Singer thesis. And many resource curse literature reviewed to date do not explore the context in which the Prebisch-Singer thesis is anchored.[56] They merely refer to it and brush it aside as being effectively negated by empirical evidence of price fluctuations.[57]

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52 Paul Stevens, in 'Resource Impact – Curse or Blessing?: A literature Survey' (London: Centre for Energy, Petroleum and Mineral Law and Policy, University of Dundee, March 2003) p.10.

53 M. A. Adelman, 'Oil Fallacies' (1991) 82 *Foreign Policy* p.3, at p6.

54 For the full history of world crude oil prices, see http://www.ioga.com/Special/crudeoil_Hist.htm Futures prices on the New York Mercantile Stock Exchange was much higher; by 8 August 2007, it was selling at US$72.15 per barrel. See http://www.wtrg.com/daily/crudeoilprice.html <Accessed 09.08.07>.

55 Keith Khol, 'Your Last Chance to Tap the Bakken Oil Play' in *Energy and Capital*, dated Friday, 9 May 2008.

56 For instance, see Michael L. Ross, 'The Political Economy of the Resource Curse' (1999) 51.2 *World Politics* p.297, at p.300.

57 For instance, Steven, above n52, at p.10.

Singer explains that the declining terms of trade argument was part of a wider policy to diversify an economic base from reliance on a single or a few natural resource projects into manufactures.[58] He argues that 'while it was recommended as part of industrialization, reduction of risk of price volatility, creation of employment, as well as future savings of imports, [it] was not in itself an escape from deteriorating barter terms of trade…'[59] He points out that in the 1940s and 1950s, *development* and *industrialization* were treated as being synonymous. Therefore, the declining terms of trade argument was part of the general argument on the need for industrialization in order to diversify a developing country's source of income.[60]

The Prebisch-Singer argument is interesting because the resource-poor 'Asian Miracle' economies prospered after moving into industrialization since they had hardly any natural resources for export.[61] Many resource curse theorists wrongly paint the view that resource-rich Latin American nations went into industrialization only to substitute manufactured imports rather than to export manufactured products as the resource-poor Asian nations did.[62] But from Prebisch and Singer's argument, there is no doubt that that view is incorrect.[63] Latin America and other resource-rich developing countries were also encouraged to pursue manufacturing in order to substitute imports as well as for exports.

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58 Singer, above n49, at p2.
59 Ibid.
60 Id., at p1.
61 The World Bank, *The East Asian Miracle: Economic Growth and Public Policy* (1993).
62 For example, Richard M. Auty, *Sustaining Development in Mineral Economies: The Resource Curse Thesis* (1993); --------, *Patterns of Development: Resources, Policy and Economic Growth (*1995).
63 Hans W. Singer, 'U.S. Foreign Investment in Underdeveloped Areas: The Distribution of Gains Between Investing and Borrowing Countries' (1950) 40 (2) *The American Economic Review* p.473.

George Zanias's comprehensive empirical studies on this subject support the Prebisch-Singer thesis.[64] Zanias's study is based on the World Bank's set of data by Grilli and Yang (1988) for the period 1900-1986, which, according to Zanias, is the best set of data that exists to date on this issue.[65] Extending on Grilli and Yang's study, and his analysis of other sets of data covering almost the whole of the 20th century, Zanias makes the following conclusion:

> Although the relative prices of primary commodities (compared to manufactured goods) have not been falling gradually in the way implied by a time trend, two major negative structural breaks last century led to a decline in the relative prices of primary commodities. These downward shifts brought the terms of trade down to nearly one-third of their level at the beginning of the century. This is a very large deterioration in the terms of trade. In the intervening period of more than six decades between the two breaks, and despite the fluctuations, the mean level of the terms of trade was maintained.
> This finding has very important implications especially for the developing countries, which rely heavily on earnings from primary commodity exports to finance their development process. Specialization in primary commodity production seems to be detrimental in the long run.[66]

Zanias's findings reveal that the decline in the terms of trade is not a continuous trend in time, but takes place in 'installments' or intermittently.[67] Such unpredictable and intermittent hiccups have serious policy implications because unlike gradual trends, the random shocks can cause permanent damage to primary commodity-based economies.[68]

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64 George P. Zanias, 'Testing for Trends in the Terms of Trade Between Primary Commodities and Manufactured Goods' (2005) 78 (1) *Journal of Development Economics* pp.49-59.

65 E. R. Grilli and M. C. Yang, 'Primary Commodity Prices, Manufactured Goods Prices, and Terms of Trade of Developing Countries: What Does the Long-run Show?' (1988) 2 *World Bank Review* pp.1-48.

66 Id., at pp.58-59.

67 For a discussion on the time series method and the cyclical movements, see John T. Cuddington and Carlos M. Urzua, 'Trends in Cycles in the Net Barter Terms of Trade: A New Approach' (1989) 99 (369) *The Economic Journal* p.426.

68 Zania rejects Dimitris Diakosavvas and Pasquale L. Scandizzo's argument in 'Trends in the Terms of Trade of Primary Commodities, 1900-1982: The Controversy and Its Origins' (1991) 39 (2) *Economic*

Since prices cannot be predicted, it can seriously affect fiscal and budgetary policies. To mitigate such shocks, Zanias suggests greater export diversification by the developing countries. 'This is a risk reducing and export revenue increasing policy, and it should be a prime goal.'[69] Zanias's findings and suggestions comprehensively support what Prebisch and Singer have been saying all this time.

After reviewing relevant literature on this issue, Michael Ross also agrees that the aggregate terms of trade for primary commodities have declined since at least the beginning of the twentieth century. In his view, the decline was caused by four factors: (1) the rise in the volume of primary commodity exports; (2) as a symptom of the debt crisis and its attendant structural adjustment programs of the 1980s; (3) the collapse of international commodity agreements; (4) after 1989, the fall of the centrally planned economies of Eastern Europe; and (5) the 1997-1998 Asian financial crisis which reduced the demand for commodities and consequently sent the prices spiraling downwards.[70] Therefore, decline in the terms of trade for primary commodities and price fluctuations causing revenue volatility can harm the economy of a resource-rich developing country.[71]

III. DEPENDENCY CAUSES AND EXPLANATIONS

Dependency theory, developed by economists trained in neoclassical economics, has historical roots in Latin American underdevelopment discourse, particularly with the

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Development and Cultural Change, p.231, that deterioration in a country's terms of trade only provides information about changes in prices and does not affect the country's welfare (at p.251).

[69] Zanias, above n64, at p.59.

[70] Ross, above n56, at pp301-302.

[71] Elissaios Papyrakis and Reyer Gerlagh, 'The Resource Curse Hypothesis and Its Transmission Channels' (2004) 32 *Journal of Comparative Economics* p.181, at p190 confirm that deteriorating terms of trade is one of the transmission channels.

work of Andre Gunder Frank.[72] Frank's 'development of underdevelopment' theory was 'one of the firm classics of dependency theory and a solid rejoinder to the mainstream rhetoric of Lewis and Rostow' in modernization discourse.[73] Unlike Prebisch and others who held positive views about the role of Third World elites in fostering economic growth and development, Frank argued that the collusion between Third World elite and monopoly capital from the industrialized 'centre' was one of the leading factors causing underdevelopment in the periphery. Rejecting the 'Dual Sector Model' of Sir William Arthur Lewis[74] and the 'Linear Stages of Growth' theory of Walt Whitman Rostow[75] and their followers in modernization discourse, Frank argued that capitalism had penetrated all corners of the globe since its emergence in the sixteenth century. The Third World was not a 'backward' region that would 'catch up' with the industrialized world. Rather, it was a region of underdevelopment that was necessary for the metropole's prosperity. Accordingly, the 'core' and 'periphery' are not separate entities but two sides of the same integrated global capitalist system. In Frank's words:

> A mounting body of evidence suggests…that the expansion of the capitalist system over the past centuries effectively and entirely penetrated even the apparently most isolated sectors of the underdeveloped world. Therefore, the economic, political, social, and cultural institutions and relations we now observe are the products of the historical development of the capitalist system no less than are the seemingly more modern or capitalist features of the national metropoles of these underdeveloped countries.[76]

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72 Frank, Baran, Paul M. Sweezy and Immanuel Wallerstein were non-Latin American underdevelopment theorists whose work became influential because they were able to publish in English whereas similar views of the Latin Americans were not.

73 Editorial Note in Rajani Kannepalli Kanth (ed), *Paradigms in Economic Development: Classic Perspectives, Critiques, and Reflections* (1994) p.149. Andre Gunder Frank's article, 'Development of Underdevelopment' appears in chapter 7 of this book.

74 William Arthur Lewis, *The Theory of Economic Growth* (1955).

75 Walt Whitman Rostow, *The Stages of Economic Growth* (first published 1966, 1990 ed).

76 Andre Gunder Frank, 'The Development of Underdevelopment' in Kanth ed., above n73, at pp.150-151.

Like Frank, the Latin American dependency theorists argued that:

> The incorporation of Latin America into the capitalist world economy, directly through (Spanish and Portuguese) colonial administration, but more subtly through foreign trade, geared the region's economies toward demands from the center, even when the export economy was locally owned. Dependence skewed the region's social structure so that local power was held by a small ruling class that used the gains from exporting for luxury consumption rather than investment. Real power was exercised from external centers of command in dominant ("metropolitan") countries. Dependence continues into the present through international ownership of the region's most dynamic sectors, multinational corporate control over technology, and payments of royalties, interests, and profits.[77]

'By dependence', Santos explained, 'we mean a situation in which the economy of certain countries is conditioned by the development and expansion of another economy to which the former is subjected.' He continued: 'The relation of interdependence between two or more economies, and between these and world trade, assumes the forms of dependence when some countries (the dominant ones) can do this only as a reflection of that expansion, which can have … a negative effect on their immediate development.'[78] Referring to Santos's works, Diana Hunt explains that the impetus to develop the dependency theory arose from the crisis of structural development theory under which import-substituting industrialization policies led to greater dependency on foreign trade, capital and technology, instead of providing greater independence of foreign trade and increased national autonomy.[79]

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[77] Peet & Hartwick, above n36, at p.107.

[78] Theotonio Dos Santos, 'The Structure of Dependence', (May 1970) IX, 2, (2), *American Economic Review: Papers and Proceedings*, p.231.

[79] Hunt, above n22, at p.203.

What this means, in essence, is that 'because of unequal political, military and economic relationships between a dependent economy and the dominant external economy, the structure of the former is shaped as much or more by the requirements of the external economy as by its own domestic needs. The domestic political economy is not only shaped by the interaction with a more powerful external economy, but is also shaped by the process.'[80] This dominant-dependent relationship leads to a situation where development alternatives open to dependent nations are defined and limited by its integration into and functions within the world capitalist market.[81] '*This limitation of alternatives differs from limitations in the dominant nations in so far as the functioning of the basic decisions in the world market…are determined by the dominant nations. Thus the dependent nations must make choices in a situation in which they do not set the terms or parameters of choice*.'[82] Inhibiting development choices open to dependent nations is caused by external factors as much as domestic ones. As Sunkel explains:

> Foreign factors are seen not as external but as intrinsic to the system, with manifold and sometimes hidden or subtle political, financial, economic, technical and cultural effects inside the underdeveloped country... Thus, the concept of "dependencia" links the postwar evolution of capitalism internationally to the discriminatory nature of the local process of development, as we know it. Access to the means and benefits of development is selective rather than spreading them. The process tends to ensure self-reinforcing accumulation of the privilege for special groups as well as the continued existence of a marginal class.[83]

Foreign factors continue to maintain power and exert influence over development policies of developing countries because when the imperialist powers retreated upon

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80 Kema Irogbe, 'Globalization and the Development of Underdevelopment of the Third World' (Spring 2005) 22 (1) *Journal of Third World Studies* p.41, at p.42.

81 Ira Katznelson, et al. (eds), *The Politics and Society Reader* (1974) pp.175-176, cited by Irogbe, id, at p.44.

82 Id, at pp.175-176. Italics supplied for emphasis.

83 Osvaldo Sunkel, 'Big Business' and 'Dependencia' (April 1972) *Foreign Affairs* p517.

attainment of political independence, they handed power over to their internal collaborators.[84] '*They did not hesitate to create and finance political parties in opposition to real nationalist one; and they also rigged elections and used various other means to make sure that they handed power over to those who would continue with the colonial policies in the nominally independent countries*.'[85]

> Therefore, the convergence of interests between the local bourgeoisie and external capitalists is one of the causes of underdevelopment. Since the internal *compradors* greatly benefit from their dependent relationship they cannot find alternative routes to development. Their economic policies, investment choices, and laws are designed and geared towards protecting their interests and that of their foreign capitalists. Such a political economy ensures that foreign factors of production like capital and technology become the main determinants of economic progress and socio-political life. 'This historical dependency has been the rooted problem of the underdevelopment of the peripheral world.'[86]

IV. WORLD-SYSTEMS CAUSES AND EXPLANATIONS

The world-system theory recognizes and builds on the existence of this global capitalist system in which the dominant powers dictate development trajectories of the periphery.[87] The modern world social system as a world-economy comprises *core-states*, *semi-peripheral areas* and *peripheral areas* in which political and economic relations among them necessitate the perpetual status of underdevelopment in the periphery.[88] Capitalism

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[84] See Daniel Offiong, *Imperialism and Dependency* (1980) p.74.

[85] Irogbe, above n80, at p.44. Italics supplied for emphasis.

[86] Ibid.

[87] World-systems theory was first developed by Andre Gunder Frank and popularised by Immanuel Wallerstein in four volumes of *The Modern World-System*. The first volume deals with the origin and conditions of the European world-system from 1450-1540. The second volume deals with the consolidation of this system between 1640 and 1815. The third volume looks at the conversion of this system into a global capitalist economy as a consequence of industrialization and technological innovations. This period is between 1815 and 1917. The fourth volume deals with the consolidation of the capitalist world-economy from 1917 to the present.

[88] Immanuel Wallerstein, *The Modern World-System: Capitalist Agriculture and the Origins of the European World-Economy in the Sixteenth Century, Volume I* (1974) p.347.

has survived since the sixteenth century owing to the power disparity between the core-periphery structure among nation-states of the world. The nature of capitalism in the world systems model is such that:

- Capitalism is able to flourish because the world-economy has had within its bounds not one but a multiplicity of political systems.
- Capitalism is based on the constant absorption of economic loss by political entities, while economic gain is distributed to "private" hands.
- Capitalism, as an economic model, is based on the fact that the economic factors operate within an arena larger than that which any political entity can totally control.
- All the above give capitalists a freedom of maneuver in the world capitalist system which is structurally based.[89]

Since capitalism in the world-economy has no boundaries like nation-states which have political boundaries, the bourgeoisie is the universal class that seeks to organize political life to pursue its interests and objectives against two opponents: the traditional class and the workers. Strong nation-states from the core facilitate and support this endeavour. Weak states of the periphery cannot effectively play the role of coordinating a complex industrial-commercial-agricultural mechanism. Rather they simply become one set of landlords among others, with little claim to legitimate authority over their whole economy and country, and contented to collect rents.[90] This rent-collecting state in 'the core-periphery relationship was brought into existence by extra-economic plunder, conquest, and colonialism, and is sustained by the normal operation of political-military

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[89] Id., at p.348. Italics supplied.
[90] Id., pp.355-356.

and economic competition in the capitalist world-economy.'[91] In this core-periphery relationship:

- Core labour is organized by the wage system in which competition in the labour market determines wages. Thus, core workers are generally protected labour in the sense of strong trade unions, welfare legislation, and such other politically articulated institutions that insulate and protect them from the effects of competitive capitalism.[92]
- This is generally not the case for the periphery worker. Peripheral labour is coerced or exploited labour.[93]
- 'No state represents the "general" interests of the capitalist class as a whole. Rather, subgroups of the world capitalist class control particular states. This multicentric structure of the world capitalist class allows the process of competitive capitalist uneven development to continue.'[94]

Latin America, Africa and Asia were incorporated as dependent peripheral states into the core capitalist states comprising Europe, North America and Japan. The peripheral states supplied hydrocarbon, mineral and agricultural products, which suited the needs of the dynamic centre.

> The periphery's resources were used in such a way that the major gains and accumulation of capital from international trade in primary products were reaped by the centre or core nations. Vested minority interests associated with the conditioned social structure of the

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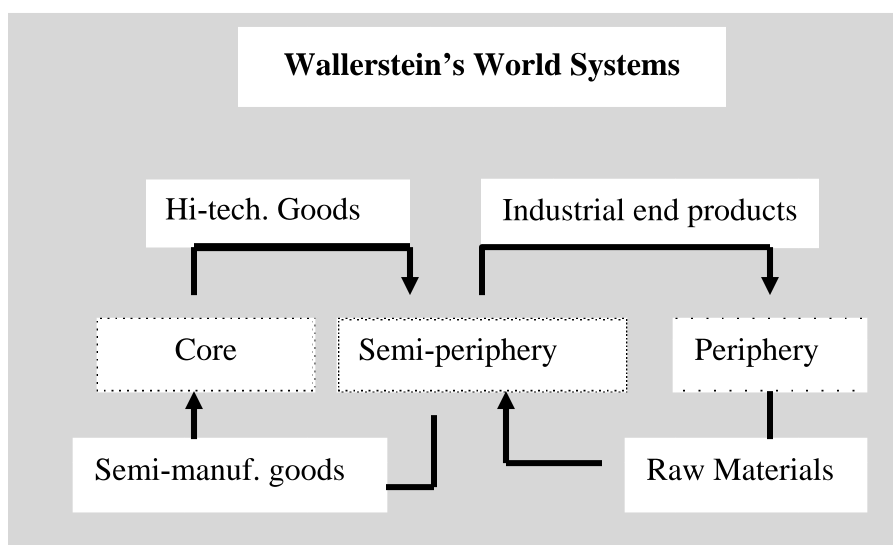
91 Christopher Chase-Dunn, *Global Formation: Structures of the World-Economy* (1989) p.39.
92 Ibid.
93 Resource curse theorists call lower wages 'competitive' and necessary to launch industrialization. Dual salary systems in Papua New Guinea, for example, where a Papua New Guinean university lecturer gets less pay than his expatriate colleague, though both may possess equal qualifications from the same university, ably demonstrate this point.
94 Chase-Dunn, above n91, at pp.41-42.

> periphery benefited from skewing of its resources while the masses remained in poverty. Peripheral societies, then, are not in a transitional state from precapitalist structures toward capitalism which developed pari passu and in direct relation to the needs of the core of the world economy. It is thus incorrect to speak of "modernizing" the periphery.[95]

Peripheral states are not in a state of transition to modernization or industrialization because of the unequal relations in the world capitalist system that makes this difficult. Rather, their 'development' for the benefit of the rich core causes and keeps them at a stagnated state of 'underdevelopment'.



V. IMPERIALISM AND MONOPOLY CAPITALISM CAUSES AND EXPLANATIONS

A. Imperialism Causes and Explanations

The theory of imperialism, defined as '*the political expression of the accumulation of capital in its competitive struggle for control*' over sources of natural resources supports

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[95] Philip Ehrensaft, 'Polarised Accumulation and the Theory of Economic Dependence' in Peter C. Gutkind and Immanuel Wallerstein (eds), *The Political Economy of Contemporary Africa: Volume 1, Sage Series on African Modernisation and Development* (1976) p.58 at p.60.

the dependency and world systems explanations.[96] Imperialism explains the use of political and military force to secure external supplies of natural resources such as oil and minerals critical to the economic survival and wellbeing of industrialized nations. Karl Marx described this role of the nation-state as '*the concentrated and organized force of society [used] to hasten, hothouse fashion, the process of transformation of the feudal mode of production into the capitalist mode, and to shorten the transition'* by means of force, which is '*the midwife of every old society pregnant with a new one*.'[97] Marx explained that the plunder of peripheral resources by Western powers using concentrated power of society in the nation-state was one of the chief means of primitive accumulation. As he described it:

> The discovery of gold and silver in America, the extirpation, enslavement, and entombment in mines of the aboriginal population, the beginning of the conquest and looting of East Indies, the turning of Africa into a warren for the commercial hunting of negroes, signalized the rosy dawn of the era of capitalist production. These idyllic proceedings are the chief factors of primitive accumulation.[98]

But what Marx described is *primitive* accumulation, meaning *original* accumulation, under the old imperialism. The new imperialism, according to Magdoff, is about 'the competitive struggle among the industrialized nations for dominant positions with respect to the *world* market and raw material sources. *The structural difference which distinguishes the new imperialism from the old is the replacement of an economy in which many firms compete by one in which a handful of giant corporations in each*

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[96] Rosa Luxemburg, *The Accumulation of* Capital (Agnes Schwarzschild trans, with an Introduction by Joan Robinson, 1963) p.446.

[97] Marx, above n11, at p.372.

[98] Ibid.

industry compete.'[99] For Amin the world already experienced two phases of imperialism and is now entering the third phase.

> Today we see the beginnings of a third wave of devastation of the world by imperialist expansion, encouraged by the collapse of the Soviet system and of the regimes of populist nationalism in the Third World. The objectives of dominant capital are still the same – the control of the expansion of markets, the looting of the earth's natural resources, [and] the superexploitation of the labour reserves in the periphery… The ideological discourse designed to secure the assent of the peoples of the central Triad (the United States, Western Europe and Japan) has been refurbished and is now founded on a "duty to intervene" that is supposedly justified by the "defense of democracy," the "rights of the peoples," and "humanitarianism". These examples of the double standard are so flagrant that it seems obvious to the Asians and Africans how cynically this language is used.[100]

The RCT, while describing the effect of imperialism and neocolonialism causing 'superexploitation', to borrow Amin's term, chooses to call it the *curse of resource abundance* as if these resources possess cognitive faculties to curse countries that possess them. The true cause is, according to O'Connor, *neo-imperialism* of neoliberalism, which was employed by the Reagan administration in the U.S.A. as the imperatives of 'national security' against the 'communist threat' as a rhetorical bridge over the gap between neoliberal and conservative illusions and modern reality.[101] It was this illusion of development theory applied to 'contain' Communism that allowed vertically integrated oil and mineral corporations to loot peripheral resources. As Smith writes, the trumpeting of *peace, freedom, justice, rights* and *majority rule* as *grand strategies* for

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[99] Harry Magdoff, *The Age of Imperialism: The Economics of U.S. Foreign Policy* (1969) p.15. Italics supplied.

[100] Samir Amin, 'Imperialism and Globalization' (June 2001) 53 (2) *Monthly Review* pp.1-18, at p.4.

[101] James O'Connor, *Accumulation Crisis* (1984) p.237.

controlling other people and their resources are the hallmarks of the new imperialism.[102] In other words, developed countries preaching *freedom* and *democracy* or *transparency* and *good governance* are ideological constructs to justify their confiscation of peripheral resources as exemplified by the U.S. invasion of Iraq in the name of removing some fictitious weapons of mass destruction and to secure Iraq's democracy, when the unspoken motive was Iraq's oil.[103] In the view of this thesis, the RCT plays the same ideological role. Because mineral and oil resources curse the periphery, development policy makers want to liberalize and put in place market-friendly macroeconomic policies and remove government planning, funding and oversight in development programs, which will then solve the resource curse and usher in economic prosperity. This reasoning, according to the old and new imperialism theories, causes what Amin calls 'superexploitation' or what Gunder Frank calls 'development of underdevelopment' as seen above.

The neoclassical theory of *declining profitability* or *diminishing rate of return* as a result of wage and population increase in the core industrialized states supported imperialism and international trade.[104] David Ricardo (1772-1823) who developed this theory argued that in order to overcome the natural tendency of profits to fall over time when wages and the whole receipts of the farmer (employer) are equal, which would then bring an end to accumulation, 'extraordinary stimulus' must be given 'for a certain time to a particular branch of foreign and colonial trade.'[105] Ricardo reasoned that when improvements in machineries for the production of food reduce labour costs, and extension of foreign trade

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[102] J. W. Smith, *Economic Democracy: The Political Struggle of the Twenty-first Century* (4th ed, (2005) p.90. Italics are original.

[103] Michael Klare, *Blood and Oil: The Dangers and Consequences of America's Growing Oil Dependency* (2004).

[104] J. A. Hobson, *Imperialism: A Study* (1902).

[105] David Ricardo, *The Principles of Political Economy and Taxation* (with Introduction by Michael P. Fograty, 1962) pp.70-71.

allows the importation of cheap commodities, prices of goods will fall and raise profits.[106] When profits rise and are accumulated, then they must be quickly employed productively before wages rise to eat up such accumulation.[107]

One way to employ this accumulated capital was by expanding the world capitalist market where investments could be made. Hence, imperialism and colonialism were the means by which this could be done.[108] As we saw earlier, imperialism facilitated 'the urgency to develop a world market' in line with Ricardo's theory, which is characterised by '*the struggle to control foreign sources of raw materials, the competitive hunt for colonies, and the tendency towards concentration of capital'. Therefore, '[i]mperialism is not a matter of choice for a capitalist society; it is the way of life of such a society.'*[109] Sweezy describes this imperialist imperative to arise from the following capitalist way of life in the international political economy:

- Several advanced capitalist countries stand on a competitive footing with respect to the world market for industrial products;
- Monopoly capital is the dominant form of capital;
- The contradictions of the accumulation process have reached such maturity that capital export is an outstanding feature of world economic relations. As a consequence of these basic economic conditions, we have two further characteristics, which are:

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106 Id., at p.80.
107 Id., at p.193.
108 Many studies have considered this issue at some length. See for example, Chase-Dunn, above n91, pp.221-225; Cf. David Harvey, *The Limits to Capital* (1982) and Daniel Chirot, *Social Change in the Twentieth Century* (1977). See also Samir Amin, *Accumulation on a World Scale* (1974); -----, *Unequal Development* (1975); ------, *Imperialism and Unequal Exchange* (1977).
109 Magdoff, above n99, at pp.26-27. Italics supplied for emphasis.

- severe rivalry in the world market leading alternately to cutthroat competition and international monopoly combines; and
- the territorial division of 'unoccupied' parts of the world among the major capitalist powers (and their satellites).[110]

Colonialism comprised the first and second phases of imperialism Amin refers to above. While the first phase began with the discovery of America, the second phase was based on industrial capitalism which compelled the colonization of Africa, Asia and Oceania for raw materials and markets. Neocolonialism and globalization are part of the third phase, the new imperialism Magdoff, O'Connor and Amin describe. The new imperialism is characterised by concentrated capital of monopoly capitalists. Sadly, this aspect of the global economic reality and its consequences are never examined by the RCT; not even by modernisation theory.

B. Monopoly Capitalism Causes and Explanations

According to neo-Marxists, global competition for market and raw materials by powerful nation-states and their transnational corporations, which causes 'superexploitation' or 'underdevelopment' is caused by the *concentration* and *centralization* of capital. This view is built on Marx's observation that under the then emerging capitalist mode of production, compared to the pre-capitalist mode of production under feudalism, property (land), capital (machineries and factories) and commodities produced were *concentrated* in the capitalists.[111] Marx pointed out that the emerging capitalist mode of production annihilated the feudal mode and caused individuals to be freed from their feudal bonds.

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[110] Paul M. Sweezy, *The Theory of Capitalist Development: Principles of Marxian Political Economy*, (1942) p.307.

[111] Marx, above n11, at p.378.

Then the new capitalists in whose hands land and capital was *concentrated* exploited the freed individuals of their labour power. As he describes it, 'the expropriation of the great mass of people from the soil, from the means of subsistence, and from the means of labour, this fearful and painful expropriation of the mass of the people forms the prelude to the history of capital.'[112] Once individuals were driven off the land and transformed into capital with labour for sale, 'it is no longer the labourer working for himself, but the capitalist exploiting many labourers. This expropriation is accomplished by the action of the immanent laws of capitalistic production itself, by the centralization of capital.'[113] This is to say that capitalist exploitation, which leads to poverty and underdevelopment, is caused by concentration of wealth and the means of wealth production in the hands of a very few hands who wield monopoly powers.

Concentration is possible when one capital kills many. As Marx puts it: '*One capitalist always kills many. Hand in hand with this centralization, or this expropriation of many capitalists by few, develop…the economizing of all means of production…the entanglement of all peoples in the net of the world market, and with this, the international character of the capitalistic regime*.'[114] The result is monopoly capitalism.[115]

This explains why the 'free market' dogma has caused deregulated monopoly capitalism to kill many capitalists through merges, acquisitions and privatisations that has led to concentration of vast wealth in the hands of a very few and caused the gulf between the rich and the poor to widen over the last three decades since the ascendance of neoliberalism. In developing countries, monopoly capitalists from the metropolitan

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[112] Id, at p.378.
[113] Ibid.
[114] Ibid. Italics supplied for emphasis.
[115] Ibid.

centres of world capitalism have used the Washington Consensus through IFIs and aid agencies to secure wealth-producing resources such as land and natural resources.[116] For example, 'land reform', often imposed as a key conditionality by international financial institutions (IFIs) and donor agencies, is promoted in the name of strengthening the institution of 'private property' as being one of the key engines of economic growth. The neoliberal crusaders often obfuscate or disregrad the evidence that such policies displaces people from their natural dependence on land, causes urban migration and dependence on government 'handouts', ultimately placing them in a vicious cycle of poverty.

The world credit meltdown in beginning in 2007 sparked by the subprime mortgage crisis in the U.S. has caused a few large banks, with the help of their governments using taxpayer funds, to buy out failing financial institutions, again vindicating Marx's observation that one capitalist always kills many. Indeed, long before the credit crunch, massive privatisation and shrinking of the public sector following the 1997 Asian financial crisis caused by speculative finance, and the 2001 economic crisis of Argentina are indisputable consequences of monopoly capitalism.

Marx thought that monopoly capitalism would signal the end of capitalism and transition into a socialist mode of production which would eventually lead to a communist mode. However, competitive capitalism did not mark the end of capitalism, but the beginning of a new stage of capitalism. So, in attempting to analyse this new stage of capitalism,

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[116] In PNG, for instance, Orogen Minerals Limited was killed as part of IMF/World Bank loan conditionality, which, if it had not been, Petromin would not have been established and incorporated subsequently by the PNG government. On Indonesia, see Steven Radelet and Jeffrey Sachs, 'The Onset of the East Asian Financial Crisis' (Harvard Institute for International Development, 30 March, 1998), a paper online at http://www.earth.columbia.edu/sitefiles/File/about/director/pubs/paper27.pdf. <Accessed 08.01.09>.

followers of Marx from the Austrian Rudolf Hilferding (1877-1941) to the American Thorstein Veblen (1857-1929), the Polish Michal Kalecki (1899-1970) and Rosa Luxemburg (1870-1919) to the American Paul Baran and Paul Sweezy (1910-2004), among others, contributed in various ways to the theory of monopoly capitalism.[117] Sweezy and Baran popularized the theory in their book *Monopoly Capital: An Essay on the American Economic and Social Order* published in 1966. But before that publication, Sweezy had already introduced the theory in his 1942 book *The Theory of Capitalist Development: Principles of Marxian Political Economy*. In chapters 14 and 15, Sweezy picks up and builds on Marx's theory of *concentration* and *centralization* of capital both of which combine to form monopoly capitalism.

Sweezy asserts that concentration of capital takes place when accumulation by individual capitalists makes it possible for an enlarged scale of production. '*Concentration in this sense is a normal accompaniment of accumulation and obviously cannot take place without accumulation*.'[118] Concentration leads to a steady rise in the scale of production and has an inherent tendency towards the limitation of competition. An even more important process – the *centralization* of capital, supports this process of concentration.[119] Centralization of capital refers to the combining of capitals which are already in existence, and this process differs from concentration in 'that it only presupposes a change in the distribution of capital already to hand and functioning; its field of action is therefore not limited by the absolute growth of social wealth, by the

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[117] Sweezy provides a succinct survey of the historical contributions on monopoly capitalism made by these authors from Hilferding right down to his time in 'Monopoly Capitalism' published by the *Monthly Review* in its October 2004 issue, the journal which he founded and became its founding editor.

[118] Sweezy, above n110, at p.254.

[119] Marx, above n11, at p311.

absolute limits of accumulation.'[120] In other words, '*capital grows in one place to a huge mass in a single hand because it has in another place been lost by many. This is centralization proper, as distinct from accumulation and concentration*.'[121]

This concentration and centralization of wealth is described today by some as *financial socialism*, particularly with reference to the first US$700 billion 'bailout' of the American financial institutions by the U.S. government and the business subsidies it provides to its wealthy corporations.[122] The bailout money and other government subsidies are going from the poor taxpayers to the super rich.[123] According to George Monbiot, European and U.S. governments, which preach free market economics repeatedly intervene on behalf of the rich, while leaving everyone else to fend for themselves.[124] In those industrialized countries, '*the bosses of farm companies, oil drillers, supermarkets and banks capture the funds extracted by government from the pockets of people much poorer than themselves. Taxpayers everywhere should be asking the same question: why the hell should we be supporting them?*'[125]

Natural resources wealth from developing countries follows the same route to the financial institutions that finance the natural resource projects.[126] This is why Marx

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[120] Sweezy, above n110, at p.255.

[121] Ibid. Italics supplied for emphasis.

[122] George Monbiot, *Financial Socialism* in *Alternatives*, (Wednesday, 01 October 2008), online at http://www.alternatives.ca/article4147.html. <Accessed 20.01.09>.

[123] A useful critique of the financial bailout is provided by Tom Eley, *Socialism vs. The Government Bailout of Capitalism* (15 October 2008), World Socialist Website at http://www.wsws.org/tools/index.php?page=print&url=http%3A%2F%2Fwww.wsws.org%2Farticles%2F2008%2Foct2008%2Fsoci-o15.shtml. <Accessed 20.01.09>.

[124] Monbiot, above n122.

[125] Ibid.

[126] Project Finance is a big topic on its own that looks at this issue. For a quick overview, see Marco Sorge, 'The Nature of Credit Risk in Finance' (December 2004) *Bank of International Settlements Quarterly Review* pp.91-101. This article is online at http://www.bis.org/publ/qtrpdf/r_qt0412h.pdf. <Accessed 20.01.09>. For details, see Peter K. Nevitt and Frank J. Fabozzi, *Project Financing* (2000).

observed that competition and credit are two powerful agents of centralization.[127] According to Marx the credit system of the banks and financial institutions, broadly inclusive of investment houses and security markets, performs the following role:

> In its beginnings the credit system sneaks in as a modest helper of accumulation and draws by invisible threads the money resources scattered all over the surface of society into the hands of individual or associated capitalists. But soon it becomes a new and formidable weapon in the competitive struggle, and finally it transforms itself into an immense social mechanism for the centralization of capitals.[128]

Sweezy interprets this to mean that centralization of capitals through the credit system, 'in its developed form, does not imply the expropriation of smaller capitalists by larger, but the amalgamation of a number of capitals which already exists or are in the process of formation …by the smoother road of forming stock companies.' This is by far the most rapid method of extending the scale of production.'[129] So, when capital absorbs capital in this centralization process, it becomes *social capital* in contrast to *personal capital*. Social capital enables rapid accumulation unlike personal capital that can only be accumulated gradually. Without the centralization of social capital, '[t]he world would be still without railroads if it had to wait for accumulation to build up a few capitals to the point where railroad construction could be undertaken.'[130] A corporation is an essential element and integral part of the centralization process because:

- First, corporations are essential for expansion at a grand scale of production, which is impossible for individual capitalists.

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127 Marx, above n11, at p.310.
128 Marx, above n11, at p.688, quoted in Sweezy, above n110, at pp.255-6.
129 Sweezy, above n110, at p.256. Privatization and free market reforms of neoliberalism has accomplished this centralization process.
130 Marx, above n54, at p.311.

- Second, capital is endowed with the social form of capital as distinguished from private capital, and corporations assume the form of social enterprises as distinguished from private enterprises. This comes about as a result of the abolition of capital as private property within the boundaries of capitalist production itself.
- Finally, social capital and social enterprises transform capitalists into mere managers, administrators of other people's capital, and the owners of capital are transformed into mere owners, mere money capitalists.[131]

Hilferding, in her book *Finance Capital*, published in 1910, elaborates on this theme, which Sweezy picks up and comments:

> Economically the most important aspect of the corporate form of organization is the dissolution of the unifying bond between ownership of capital and actual direction of production, 'the freeing of the industrial capitalist from the function of industrial entrepreneur…' it was in developing the implications of this phenomenon that Hilferding made his most important contribution to the theory of corporations.[132]

Sweezy extends Hilferding's analysis to show that capitalism as we know today perfected the art of monopoly by alienating owners of capital who hold shares in companies to merely realize interests on capital invested if dividends are declared, and promoters to centralize and accumulate more capital from floating shares than their nominal investments. The corporate structure, therefore, has intensified the centralization process along with an acceleration of accumulation on the one hand, and on the other, facilitates formation of a relatively smaller upper layer of big capitalists whose control extends far

[131] Marx, above n11, at p.311.
[132] Sweezy, above n110, at p.258.

beyond the limits of their ownership.[133] A high degree of centralization culminates in ensuring control over competition. Since cutthroat competition is not beneficial for anyone, mergers, cartels and trusts are formed. While a merger aligns competing firms to join resources to pursue rapid accumulation, a cartel exists to fix prices and control production among members, and punish by fine those who violate their rules of operation.[134] These various combinations of instruments lead to control over the pricing of commodities, resulting in an increase on profits, which is 'the whole aim and end of monopoly.'[135]

What is the implication of monopoly capitalism in resource-rich developing countries? The Program for the Democratic Socialist Party posts on its web page some useful points on this issue. Seven of their points are relevant in this context:

- Monopoly capitalism, characterised by the accumulation of surplus capital in the hands of the monopolies of the industrialised capitalist countries, constantly seek new fields of profitable investment, which are exported to the non-industrialized areas of the world together with goods bought with the surplus capital – mainly infrastructural facilities to cheapen the export of raw materials from these areas – give them major interests and permanent control over these areas.

- Monopoly capitalism is accompanied by a feverish drive to assert political control over the non-industrialised countries of the world by converting

[133] Id, at p.261.
[134] Id., at pp.264, 270,
[135] Id., at p.272.

them into colonies, and after independence, neocolonies of the major capitalist powers.

- The massive export of capital to the colonial and semi-colonial countries (the so-called Third World) for the organisation of capitalist production of raw materials created and consolidated a specific mixture of pre-capitalist and capitalist relations of production which prevented and continues to prevent the development of large-scale industry within these countries.

- Accordingly, foreign capital's domination over the accumulation of capital in the Third World stifles the process of primitive accumulation of capital by indigenous capitalists. In this way, imperialism integrated the colonial and semi-colonial countries in the Third World into the capitalist market, and also consolidated a permanent gap in average labour productivity between the industrialized capitalist countries and the Third World.

- Superprofits are appropriated from the colonial and semi-colonial countries through the purchase of labour power at a price much lower than its value in the industrialised countries, and through unequal exchange of goods on the world market. In other words, goods produced in conditions of higher labour productivity (industrial goods) are exchanged for goods produced in conditions of lower productivity, predominantly mineral and agricultural raw materials. As a result, the imperialist capitalist countries appropriate a large part of the value produced in the Third World.

- Monopoly capitalism retards and distorts development of capitalism in the colonial and semi-colonial countries by perpetuating and intensifying their economic backwardness and dependent and subordinate relationship to the advanced capitalist countries. It creates and maintains a permanent division of the world into rich nations and poor nations, consigning the majority of humanity to perpetual destitution.

- Monopoly capitalism seriously restricts the prodigious development of the productive forces that characterised the age of laissez-faire capitalism by its artificial restriction on production and sharing of markets between big corporations, and consequently, becomes a fetter on the overall development of the productive forces that affects all aspects of capitalist societies, including economic, political, cultural, moral and social.[136]

The above theories and analysis all point to the same conclusion. Natural resources in resource-rich developing countries are owned, controlled and exploited by transnational corporations from the rich and powerful countries with the support of capitalist institutions imposed during colonialism and maintained through neocolonialism. Consequently, developing countries remain poor and underdeveloped. These are historical facts. They require no econometrics and theoretical assumptions. Without reforming the colonial institutions from its core in order to transfer ownership and control over the means of production to the citizens of developing countries, it is hypocritical to preach development and economic growth.

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[136] See Program for the Socialist Democratic Party at http://www.dsp.org.au/dsp/program/prog04.htm <Accessed 29 June 2007>.

VI. CONCLUSION

This thesis prefers the underdevelopment theory and neo-Marxist analysis of capitalism from a political economy standpoint to explain the economic stagnation and social poverty in resource rich developing countries to that offered by the RCT. In terms of policy solutions to solve the curse or underdevelopment, this thesis believes the ISI policy offered by structuralist theory is useful, although this is rejected by the RCT. While providing a superb analysis and critique of capitalist development, Marxist and neo-Marxist theories fail to provide any useful policy solution to prevent underdevelopment. However, what is generally implicit from the above review suggests that people in developing countries need to assert not only control and ownership, but also develop and own the means of production of wealth – natural resources – and undertake downstream processing. This would ensure that capital remains in their local economies.

Underdevelopment theory and neo-Marxist assumptions that natural resources would not cause capital accumulation in the periphery because they are being siphoned off to the core is vindicated by the RCT. Yet, it is strange that the RCT does not even acknowledge that its evidence affirms the assumptions of underdevelopment economics. The truth is that the vast amount of evidence on the RCT vindicates neo-Marxist and underdevelopment causes and explanations.

This thesis does not accept three assumptions of underdevelopment theory. These are, first, that developing countries would remain in a perpetual state of underdevelopment; second, that political revolution is required to severe ‘dependence’ on the core, and third, the silence on the role of cultural values and beliefs in hindering/fostering economic

development. First, history clearly demonstrates that empires and civilizations change over time. Therefore, it is necessary to provide hope in a future change instead of taking everything as gloomy, fixed and static. Second, revolutions have indeed taken place in many countries like Pakistan's military coups, or those of Fiji, or Nigeria, but things have not changed. In my view, it is not socialism or capitalism that can cause wealth distribution, social welfare and poverty reduction or economic development, but deliberate humane government policy to cause the desired outcome. Third, underdevelopment economics pays attention on exogenous factors while neoclassical/neoliberal economics dwells on endogenous factors. In my view, cultural values and beliefs play important roles in influencing political leaders of governments in policy decision-making. This area was rightly examined by modernisation theory but underdevelopment theory and the RCT are unfortunately silent on it. It is my considered view that a country needs to consider both exogenous and endogenous factors. If right policies like infant industry protection or the ISI advocated by structuralist theory, prudential management of natural resource revenue, education, infrastructure and agriculture to attain food security, for instances, are supported by government policy, then social progress and economic growth can indeed take place.

CHAPTER FIVE

ORTHODOX POLICY PRESCRIPTIONS TO SOLVE THE RESOURCE CURSE: FROM DIVERSIFICATION TO STERILIZATION AND SAVINGS

INTRODUCTION

The aim of this chapter is to critically examine orthodox policies prescribed by the resource curse theorists to solve the resource curse and their relevance to Papua New Guinea (PNG) and similar developing countries. The main prescriptions call for *institutional reforms* and *policy changes*. This chapter examines both the theoretical and practical aspects of these two prescriptions. Eight specific *policy prescriptions* and *institutional changes* have been identified from the resource curse literature. These are:

- That natural resources, particularly minerals and petroleum, should be left in the ground.
- Revenue diversification.
- Revenue Sterilization
- Savings, especially in natural resource funds.
- Encourage open trade.
- Establish good institutions.
- Transparency and good governance.
- Good investment policy and political reforms.

This chapter examines the first four policies in Sections I-IV. Section V makes some analytical comments on the policies reviewed while the final section provides a conclusion. Discussions involve examination of arguments for and against the policies with references to specific examples. Chapter Six examines the last four policies.

I. LEAVE IT IN THE GROUND

In order to avoid the resource curse, Paul Stevens proposes that, although it would seem extreme, it is better to leave natural resources in the ground.[1] Stevens' proposition is informed by a 2001 report of Oxfam America that claims that oil and mineral exports are bad for growth and bad for the poor.[2] The suggestion is not to leave minerals and oil in the ground indefinitely but to develop them at a slower pace to deal with issues of production and revenue flow, which is, according to Stevens, a commonsensical thing to do. Stevens acknowledges that project economics and discounted cash flow methodology, which underlies project appraisal favours a faster development rate. However, if a country is to address the resource curse problem, then a slower development pace is common sense.[3]

For PNG and similar resource-rich developing countries, this proposition has merit and thus requires serious consideration. One example from which to learn is the fact that resource-rich settler states like Australia and the United States (US) were exploited by companies and people from those countries. They did not have foreign companies

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1 Paul Stevens, *Resource Impact – Curse or Blessing?: A Literature Review*, (Centre for Energy, Petroleum and Mineral Law and Policy, University of Dundee, 25 March 2003)
2 Michael Ross, *Extractive Sectors and the Poor: An Oxfam America Report* (2001) p.9.
3 Stevens, above n1, at p.18.

exploiting their natural resources as it is being done in PNG and other developing countries today. Therefore, leaving natural resources in the ground until such time citizens in the developing countries acquire the capital, knowledge, skills, and technology to extract these resources themselves indeed makes common sense.

Extracting natural resources by local companies using local knowledge, skills and technology also promises to provide sufficient economic linkages in the local economy. It avoids the highly integrated and enclave nature of resource production experienced in the periphery using foreign capital, which encourages capital flight. The history of the Australian mining industry provides a good example of what can happen when local companies with local knowledge, skills and technology exploit their own natural resources. In Australia, many companies that produced tools, equipment and machines for mining sprang up because of demands of the mining industry.[4] The industry also created demand for food, so farming increased.[5] These industries in turn required good transportation, so railways, roads and bridges were constructed to service the booming sector.[6] That has also been the experience of the United States and other developed countries.[7]

Another commonsensical reason why resources should be left in the ground is so that developing countries will realize the full value. In many developing countries like PNG,

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[4] See Australian Academy of Technological Sciences and Engineering (AATSE), *Technology in Australia 1788 – 1988: A Condensed History of Australian Technological Innovation and Adaptation During the First Two Hundred Years* (1988).

[5] Ibid.

[6] Ibid.

[7] Gavin Wright and Jesse Czelusta, 'Exorcising the Resource Curse: Minerals as a Knowledge Industry, Past and Present' (Stanford University, July 2002). Available online at http://www-econ.stanford.edu/faculty/workp/swp02008.pdf <Accessed 04.06.07>.

legal regimes governing resource extraction are designed to transfer resource ownership to multinational companies for fees, royalties, taxes, and in some cases, equity.[8] But it is common knowledge that by applying clever accounting techniques, transfer-pricing, overpricing and a combination of such other practices, companies are known for minimizing the taxable income, and ensuring that as little as possible is paid to the host government.[9] As Joseph Stiglitz explains:

> It is the strategy of oil, gas, and mining companies to make sure that the government gets as little as possible – while, at the same time, helping the government find arguments for why it is good or even necessary for the government to receive so little. They may say that there are large social benefits from developing the region, and thus development should be encouraged. Giving away resources, they claim, does this. In fact, giving away resources simply means the government has less money to pay for infrastructure, schools and other facilities that are absolutely necessary if the region is to be developed.
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> …
>
> The struggle to get for the country the full values of its resources is particularly pronounced in the sale of government-owned natural assets to the private sector. Whenever the government gets less than the full value of the asset, the country is being cheated; there is a simple transfer of wealth from the citizens as a whole to whoever gets the assets as a "discount". Sometimes the wealth of the state goes to individuals within

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8 See Mako J. Kuwimb, *Examination of Papua New Guinea's Petroleum Law and Policy* (Master of Laws Honours Thesis, University of Wollongong, 1997).

9 See various articles on this in Steven Hiatt (ed), *A Game as Old as Empire: The Secret World of Economic Hit Men and the Web of Global Corruption* (2007); John Perkins, *Confessions of an Economic Hit Man: The Shocking Inside Story of How America Really Took Over the World* (2005); David Rothkopf, *Superclass: The Global Power Elite and the World They Are Making* (2008). According to an online report at http://www.polarisinstitute.org/nigeria_mobil_sued_over_tax_evasion, <accessed 04.01.09>, Nigeria is suing ExxonMobil for tax evasion. Many other examples of tax evasion cases are provided by Social Watch at http://unpan1.un.org/intradoc/groups/public/documents/APCITY/UNPAN018181.pdf. <Accessed 04.01.09>. According to a CNN report online at http://money.cnn.com/2002/09/13/news/companies/chevron_texaco/index.htm, <accessed 04.01.09>, ChevronTexaco has evaded federal and state taxes from 1970 to 2000 amounting to some US$3.25 billion.

> the country rather than to a multinational corporation; still, wealth slips away that ought to belong to the nation as a whole.[10]

Therefore, if PNG and other resource-rich developing countries want maximum benefits from their natural resources, then they should seriously consider leaving them in the ground until their own citizens are educated, trained and prepared to extract the resources themselves.

II. DIVERSIFICATION

Another proposition to solve the resource curse is to diversify a country's revenue base. As we saw in Chapter Two, Richard Auty argues that lack of diversification is one of four causes of the resource curse.[11] Auty explains that diversification in resource-poor countries of East Asia commenced with competitive manufacturing at a *lower per capita income* compared to resource-rich Latin America which commenced import-substitution industrialization (ISI) at higher wages for workers. Auty identifies three key factors for the successful Asian diversification:

- Asians have fewer options for primary production compared to those in resource-rich Latin America, so relying on cheap labour supply to commence industrialisation was the only way forward.

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[10] Joseph E. Stiglitz, *Making Globalization Work: The Next Steps to Global Justice* (2006) p.250.

[11] Richard M. Auty, 'The Resource Curse Thesis: Minerals in Bolivian Development, 1970-90' (1994) 15 (2) *Singapore Journal of Tropical Geography* pp.95-111; -----, Richard M. Auty, *Sustaining Development in Mineral Economies: The Resource Curse Thesis* (1993). The first three causes are (1) rent extraction and inequitable distribution, (2) lack of market discipline in the midst of abundance, and (3) trade policy closure: see Richard M. Auty, 'The Political Economy of Resource-driven Growth' (2001) 45 *European Economic Review* p.839, at p.840.

- Right from the beginning, Asians have realized that at a relatively low-level income, a small resource-sector vis-à-vis the rest of the economy cannot sustain slow-maturing industry or a bloated government bureaucracy because the fraction of rent they earn is significantly less compared to those in resource-rich Latin America.
- Asians understood that competitive manufacturing could not afford the higher cost of inputs from protected infant industry so they favoured open trade.[12]

Auty interprets all these to mean that the pressure on *competitive manufacturing from a low level of income per capita* to maintain an open trade policy and invest efficiently in resource-poor countries is stronger than in resource-rich countries. 'As a result, the pro-trade lobby is strengthened in resource-poor countries at the expense of interest groups that benefit from trade policy closer.'[13] Auty maintains this argument in several publications.[14]

The Dutch disease theorists of the 1970s and 1980s also advocated diversification.[15] But diversification was first advocated by the Prebisch-Singer thesis in the 1950s and 1960s, as we saw in Chapter Four. The Prebisch-Singer thesis advocated diversification into manufacturing to address the problem of volatile world prices of primary commodities,

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[12] Richard M. Auty, 'Industrial Policy Reform in Six Large Newly Industrialising Countries: The Resource Curse' (1994) 22 (1) *World Development* pp.11-26.

[13] Auty, 'The Political Economy of Resource-driven Growth', above n11, at p.840.

[14] All other publications by Auty cited in this thesis say the same thing in different words.

[15] Thorvaldur Gylfason, 'Lessons from the Dutch Disease: Causes, Treatment, and Cures, Institute of Economic Studies Working Paper Series' (Economics Department, University of Iceland: 22 March 2001).

and the declining barter terms of trade,[16] not only to meet domestic market demands but also for export as well.[17] Auty critiques the Prebisch-Singer thesis not because he opposes diversification and competitive manufacturing, but on the grounds that Latin American manufacturing was (1) protected by government, (2) inward-looking and against open trade, and (3) the wages of the industrial workers were high compared to the low wages in Asia.[18] Auty argues that attempts by resource-rich developing countries to reduce their dependence on natural resources by going into industrialisation backfired and caused growth collapses in the late 1970s and early 1980s. In his view, domestic 'policies to promote infant industry (which resource abundance could sustain for longer than resource-poor countries) weakened their economies during the 1960s. Thereafter international efforts to reverse the long-run decline in real commodity prices by establishing producer agreements triggered trade shocks in the 1970s that damaged their weakened economies.'[19]

However, Auty notes that diversification into manufacturing backfired because of tariff barriers put up against manufactured products from Latin American countries by the United States (U.S.) and anti-dumping lawsuits by large U.S. firms who were threatened

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[16] Raul Prebisch, *The Economic Development of Latin America and Its Principal Problems* (1950); Hans W. Singer, 'The Distribution of Gains Between Investing and Borrowing Countries' (1940) 2 *American Economic Review* p.40.

[17] Raul Prebisch, 'International Trade and Payments in an Era of Coexistence: Commercial Policy in the Underdeveloped Countries' (1959) 49 (2) *The American Economic Review* p.251, at p254.

[18] For examples, Richard M. Auty, *Economic Development and Industrial Policy: Korea, Brazil, Mexico, India and China*, (1994); Rupert G. Rhodd, 'Review: Westernizing the Third World: The Eurocentricity of Economic Development Theories by Ozay Mehmet' (1996) 63 (2) *Southern Economic Journal* pp.548-549.

[19] Richard M. Auty, 'How Natural Resources Affect Economic Development' (2000) *Development Policy Review* p.347, at p.361.

by stiff competition from those Latin American exports into the U.S. market.[20] Joseph Stiglitz and many other researchers agree with this assessment by pointing out that Latin American heavy industrial products threatened the monopolised markets of the U.S. giant corporations so strong tariff barriers were put up,[21] whereas the export commodities of the Asian economic 'Tigers' comprising mainly textile, footwear and electronic products did not.[22]

According to a 2003 study by Lindsey and Ikenson of the Washington-based Cato Institute, the U.S., as the 'the world's most frequent user of antidumping rules to repel competition', has been capitalising on domestic ignorance, even including 'members of Congress, whose opinions shape the course of U.S. trade policy,' to maintain some of the harshest and most unfair, old-fashioned trade protectionism.[23] From their summary, the relevant parts of this old-fashioned protectionism under US anti-dumping laws are as follows:

> The U.S. antidumping law enjoys broad political support in part because so few people understand how the law actually works. Its rhetoric of "fairness" and "level playing fields" sounds appealing, and its convoluted technical complexities prevent all but a few insiders and experts from understanding the reality that underlies that rhetoric. … Even members of Congress, whose opinions shape the course of U.S. trade policy, are baffled by those devilish details. … The inescapable

[20] Richard M. Auty, 'Resource-based Industrialization and Country Size: Venezuela and Trinidad and Tobago' (1986) 17 (3) *Geoforum* p.325, at pp.330, 331, 337.

[21] See Stiglitz, above n10, esp. ch 4.

[22] See Edward E. Leamer, Hugo Maul, Sergio Rodriguez and Peter K. Schott, 'Does Natural Resource Abundance Increase Latin American Income Inequality?' (1999) 59 *Journal of Development Economics* pp.3-42.

[23] Brink Lindsey and Daniel J. Ikenson, *Antidumping Exposed: The Devillish Detail of Unfair Trade Law* (2003).

> conclusion is that the antidumping law, as it currently stands, has nothing to do with maintaining a "level playing field." Instead, antidumping's primary function is to provide an elaborate excuse for old-fashioned protectionism. … What goes around comes around. As traditional tariff barriers have been gradually lowered throughout the world, antidumping has emerged to fill the void. … Steel producers and other import-competing industries have long dominated the formulation of U.S. antidumping policy. Their lobbying has made the U.S. law increasingly protectionist and caused U.S. trade negotiators to block improved international rules.[24]

Commenting on Lindsey and Ikenson's book, Robert Litan of the Brookings Institution, wrote:

> For years, American companies have taken advantage of an obscure statute - the antidumping law - to punish foreign firms that give American consumers a bargain; American companies claim that the foreign companies are 'dumping' their products in our market. In this book, Brink Lindsey and Dan Ikenson expose the hypocrisy of those attacks on practices that are engaged in by American firms on our soil, all perfectly lawfully and justifiably.[25]

Without critiquing the role of U.S. trade protectionism, Auty blames the Latin American countries for producing much more than is required for the local market. The truth is that Latin America was also producing for the export market in the U.S. as well, but the U.S. markets were protected from foreign competition. Then in the same breath, Latin America is criticised for ISI while the Asian 'economic tigers' are praised for export-

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[24] This is an online version of the summary of the book located at http://www.catostore.org/index.asp?fa=ProductDetails&method=cats&scid=14&pid=1441160 <Accessed 19.09.07>.

[25] Extracted from the online version located at http://www.catostore.org/index.asp?fa=ProductDetails&method=cats&scid=14&pid=1441160#description <Accessed 19.09.07>. Litan is the coauthor of the book *Globaphobia: Confronting Fears about Open Trade*, and coeditor of *Down in the Dumps: Administration of the Unfair Trade Laws*.

oriented industrialisation.[26] However, it is submitted that because of the Cold War, U.S. aid policy encouraged Asian industrial products access to the U.S. market, whereas regions 'contained' against the threat of Communism like Latin America were not.[27] Yet, such double standards and the role of law and politics in protecting markets in the industrialised countries receive no criticism at all from the neoliberal resource curse theorists.[28]

Many studies show that, after the end of the Cold War, both Asian and Latin American exports into markets in the OECD countries are facing tough restrictions.[29] Like the U.S., the European Union (EU) anti-dumping rules also maintain harsh restrictions against competitive products from the developing countries. For instance, a March 2006 policy submission by Peter Mandelson of the European Union Trade Commission to the European Union member countries to impose anti-dumping measures against Chinese and Vietnamese footwear products clearly reveal this.[30] Mandelson argues that the 'Chinese and Vietnamese leather shoe producers…sell their products on the European

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[26] Richard M. Auty, *Patterns of Development: Resources, Policy and Economic Growth* (1995) see esp ch.6.

[27] See Jane Harrigan, Chengang Wang and Hamed El-Said, 'The Economic and Policy Determinants of IMF and World Bank Lending in the Middle East and North Africa' (2005) 34 (2) *World Development* pp.247-270; M. McGillivray and H. White, 'Explanatory Studies of Aid Allocation Among Developing Countries: A Critical Survey' (Institute of Social Studies Working Paper No. 148, Institute of Social Science, The Hague, 1993); Jane Harrigan and Chengang Wang, 'A New Approach to the Allocation of Aid Among Developing Countries: Is the USA More Selfish Than the Rest?' available online at http://www.socialsciences.manchester.ac.uk/disciplines/economics/research/discussionpapers/pdf/Discussion_paper_0412.pdf <Accessed 18.09.07>.

[28] See Michael Ross, *Extractive Sectors and the Poor: An Oxfam America Report* (2001), which provides a table of tariffs imposed by the OECD countries against industrial products from the periphery.

[29] See David Ransom, *The No-Nonsense Guide to Fair Trade*, (2001). The same attitude is also revealed in Bartlomiej Kaminski and Alexander Yeats, 'OECD Trade Barriers Faced by the Successor States of the Soviet Union' (World Bank Working Paper WPS 1175, Policy Research on International Trade, 2000).

[30] Peter Mandelson, *Europe's Anti-Dumping Measures Target Unfair Trade, Not Asia's Natural Advantages* (13 March 2006) available online at http://trade.ec.europa.eu/doclib/docs/2006/march/tradoc_127773.pdf <Accessed 19.09.07>.

market at below their true value in China or Vietnam. That is dumping, and under WTO and EU rules we have an obligation and right to combat it where it harms EU industry.'[31]

While neoliberal resource curse discourse extols the lower cost of production as a result of abundant cheap labour in Asia, the developed countries are complaining that selling cheap commodities amounts to dumping. One would argue that this is fair competition under *free* capitalism and international trade rules the rich industrialised countries themselves put in place. But that is not how the rich developed countries see it when it harms their interests. In their view, as Mandelson expresses:

> There is clear evidence that this state-supported dumping is causing serious injury to European industry. Since 2001, European leather footwear production has contracted by about 30%. Some 40,000 jobs in the sector have been lost… Import prices have fallen by about 30%. All this closely tracks the rise in unacceptably under-priced imports from China and Vietnam. Intense competitive pressure on European footwear producers is not related solely to dumped goods. China and Vietnam have natural low cost advantages in labour and manufacturing. The Commission is not arguing that this competition is unfair because wages are lower in China and Vietnam than they are in Europe. That may be tough competition – but it is fair competition. Unfair competition is when markets are rigged, disguised subsidies are freely made available. That is what we have found. These companies are taking their legitimate low cost advantage and topping it up with unfair behaviour.[32]

Mandelson admits that production cost in Asia is low, so Asian export prices are low. He has no qualms about that. However, he is concerned only because of government subsidies. If that is so, then the EU could adopt two policies. First, they should provide

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[31] Ibid.
[32] Ibid.

subsidies to their companies, just as like the Asians do. Second, in order to make EU footwear competitive, they could cut their production costs. But since the second option would entail cutting jobs and wages of European footwear workers, they do not want to take that course. With respect to the first option, developed countries are leaders in providing subsidies, but the resource curse discourse does not talk about this fact.[33] For instance, Wal-Mart, the world's largest discount store operator that made about US$9 billion in profits in 2004,[34] has received over US$1 billion in government subsidies in the last 20 years.[35] The longstanding Boeing-Airbus subsidy case between the U.S. and the EU before the World Trade Organization (WTO) also reveals how industrialised countries subsidise their large transnational corporations.[36] In Australia, the energy and transport industries received about $9.3 billion to $10.1 billion in government subsidies during 2005-2006.[37] Agricultural subsidies in these rich countries are massive and destroy agriculture in poor developing countries.[38] Under the North American Free

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[33] See for example, Peter James George, *Government Subsidies and the Construction of the Canadian Pacific Railway* (1981);

[34] CNN news online at http://money.cnn.com/2004/05/24/news/fortune500/walmart_subsidies/. <Accessed 20.05.08>.

[35] For details on the various subsidies, see Philip Mattera and Anna Purinton with Jeff McCourt, Doug Hoffer, Stephanie Greenwood and Alyssa Talanker, *Shopping for Subsidies: How Wal-Mart Uses Taxpayer Money to Finance Its Never-Ending Growth* (Washington D.C.: Good Jobs First, May 2004).

[36] See Robert J. Carbaugh and John Olienyk, 'Boeing-Airbus Subsidy Dispute: A Sequel' (2004) 4 (2) *Global Economy Journal*. Available at http://www.bepress.com/gej/vol4/iss2/6. <Accessed 25.01.09>. David Pritchard and Alan MacPherson, 'Industrial Subsidies and the Politics of World Trade: The Case of the Being 7e7' (2004) 1 (2) *The Industrial Geographer* pp.57-73. Available online at http://igeographer.lib.indstate.edu/pritchard.pdf. <Accessed 25.01.09>.

[37] Wendy Frew, 'Public Purse Props Up Fossil Fuel Industries' in *The Sydney Morning Herald* dated 8 May 2007, online at http://www.smh.com.au/articles/2007/05/07/1178390228019.html#. <Accessed 20.05.08>.

[38] Oxfam, Oxfam Briefing Paper, 'Top the Dumping! How EU Agricultural Subsidies Are Damaging Livelihoods in the Developing World,' copy available at http://www.globalpolicy.org/socecon/trade/subsidies/2002/10stopdumping.pdf. See also, Gilbert M. Gaul, Sarah Cohen and Dan Morgan, 'Federal Subsidies Turn Farms Into Big Business', the *Washington Post* dated Thursday, 21 December 2006, online at http://www.washingtonpost.com/wp-dyn/content/article/2006/12/20/AR2006122001591_pf.html. <Both accessed 20.05.08>. These reporters found that between 2001-2006, the U.S. government had distributed $95 billion in agricultural subsidies.

Trade Agreement (NAFTA), for instance, there is unfair competition between unsubsidised Mexican corn and subsidised American corn, but poor Mexicans do not complain or, if they do, their complaints go unheeded.[39]

Agricultural subsidy is the very issue that is stalling the World Trade Organization's (WTO) multilateral trade development negotiations.[40] For instance, the EU and the U.S. have argued that if they are to reduce their agricultural tariffs, then Australia should reciprocate by removing its *single desk* policy – its wheat monopoly.[41] In this manner, the industrialised and rich nations pass the buck to each other and keep their subsidies in place, while recommending open trade policies to the poor Third World countries.

Competitive manufacturing from a *low level of income per capita* is the other reason the resource curse discourse offers to explain why resource-poor Asian countries succeeded while the resource-rich Latin American countries did not. However, this is only a partial view. The other side of the picture – from the view of the low level income workers - must also be presented.[42] Two Americans who lived with Nike factory workers in Indonesia in 2000 to get first-hand experience of the factory workers' living conditions found that a factory worker works from 8.00 a.m. to 8.00 p.m. (excluding travel time) from Monday to Saturday and sometimes Sunday, and earns $1.25 per day. They recall their experience:

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39 Stiglitz, above n21, at p.64.

40 See Thomas Hertel, Roman Keeney and L. Alan Winters, *Why WTO Agricultural Reforms Are Such a Good Idea – But Such a Hard Sell?* (22 October 2007), available online at http://www.voxeu.org/. <Accessed 26.10.07>.

41 Peter Balas, deputy director-general for trade of the EU made this argument – available online at http://www.abc.net.au/news/stories/2007/03/08/1866783.htm <Accessed 19.09.07>.

42 Loretta Napoleoni, in *Rogue Economics: Capitalism's New Reality* (2008) provides some useful views on the other side of the Asian 'success' story.

> Like Nike's workers, we lived in a small 9x9 cement box, with no furniture and no air conditioning – in this steaming tropical city. We slept on thin mats on an uneven cement floor covered in shelf paper, which had a constant layer of ash and grit from the burning garbage, factory pollution, and car exhaust fumes. The toilets drained into open sewers on both sides of every street. Because of the sewers, the village was infested with fist-sized cockroaches and the biggest rats we'd ever seen.
>
> Some people say to us, "You can live like a king on $1.25 a day in a place like Indonesia." It's a statement filled with apathy and misinformation. Most who make such claims have never even been to Indonesia.
>
> …
>
> You are exhausted. You feel tired in your bones. You are afraid that if you speak up, you'll lose your job. And the multinational company you work for is telling the world that you've made serious changes, and consumers need not worry. You are 100% happy.
>
> Unfortunately, it wasn't just Nike workers who lived in these conditions and on these wages. We spoke to people producing for Adidas, Reebok, The Gap, Old Navy, Tommy Hilfiger, Polo, Ralph/Lauren, Lotto, Fila and Levi's. All earned the same poverty wages, lived in the same type of slums, and had the same requests of their corporate buyers: give us higher wages and the freedom to organize independent unions.[43]

Who then gains from competitive manufacturing from low level of income per capita? According to John Perkins: 'Wealthy Indonesians and foreigners gained, while the majority of Indonesians suffered.'[44] Perkins then points out:

> Other victims of the 'economic miracle' are the Bugis, Dyaks, Melanesias, and other indigenous cultures; their lands have been stolen and their lives and traditions destroyed. This modern genocide cannot be measured solely in terms of human suffering; it is an attack on the soul of humanity, and especially discouraging in light of earlier genocides,

[43] Jim Keady and Leslie Kretzu, quoted in John Perkins, *The Secret History of the American Empire: Economic Hitman, Jackals, and the Truth About Global Corruption*, (2007) at pp.41-42.

[44] Perkins, id., at p.47.

> including ones conducted in the United States against our indigenous people. While those are condemned today, the model is repeated – and financed by the U.S. government and our corporations.[45]

So, the price for competitive manufacturing from a low level of income per capita in resource-poor developing countries produces the very same socio-economic result the resource curse discourse seeks to eradicate. For instance, according to a 2008 study, notwithstanding 'China's economic achievements in the last two decades, the market reforms have also brought about a widening income gap, reduction in social welfare, and rising unemployment.'[46] Because a few individuals and multinational corporations gain while the majority suffer, neoliberal theory erroneously assumes that the gain by those few trickles down equitably to the majority. This fallacious assumption leads to the recommendation that competitive manufacturing from a lower level of income per capita is attractive. But the same paradox remains: most people in developing countries that are experiencing economic growth as a result of competitive manufacturing remain just as impoverished as their comrades in the resources-rich but poor developing countries. This vindicates the causes and explanations of underdevelopment economics than that of the RCT and neoliberalism. Underdevelopment economics explains that in resource-poor developing countries, it is labour that is exploited by core capitalists with the support of local bourgeoisie under conditions of neocolonialism, while in resource-rich developing countries it is the natural resources that get exploited. Globalization deepens and expands these two forms of exploitation. The resource curse discourse then uses industrialisation

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[45] Perkins, ibid. See also John Pilger, *The New Rulers of the World* (2002), esp ch.2.

[46] Fei Yan, 'The Rising Poverty and Urban Resentment in a Transitional China: The Experience of Shanghai' (March 2008) 1 (1) *Journal of Politics and Law* pp.15-23.

in resource-poor developing countries through *labour exploitation* as a model to blame victims of *natural resource exploitation* in resource-rich developing countries.

One more issue on diversification remains to be considered. While criticising diversification based on the Prebisch-Singer thesis, the RCT recommends diversification based on the Dutch disease model. How can one understand this hypocritical contradiction? Since the Dutch disease explanation originated from the economic North, it is now generally accepted without much dispute, while the declining barter terms of trade and volatility thesis, which originated from the economic South, is subjected to critical disputes.[47] According to Joseph Stiglitz, this happens because in the international arena, '*the voices of developing countries are heard too little, and the voices of [the industrialized nations and] special interests are heard too loudly*.'[48] That explains why underdevelopment economics, which explains the same economic effects that the RCT describes, does not get heard while the RCT is being heard loudly.[49]

III. REVENUE STERILIZATION

According to neoclassical-neoliberal economics, revenue sterilization is a key part of a country's macroeconomic policy. Again, according to Auty, revenue sterilisation begins

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[47] Dimitris Diakosavvas and Pasquale L. Scandizzo, 'Trends in the Terms of Trade of Primary Commodities, 1900-1982: The Controversy and Its Origins' (1991) 39 (2) *Economic Development and Cultural Change* pp.231-264. Diakosavvas and Scandizzo provide a list of authors and the studies for and against this thesis and those who remain neutral dating back to the classical political economy era of David Ricardo and his doctrine of comparative advantage. See also Charles R. Whittlessey, 'Foreign Investment and the Terms of Trade' (1932) 46 (3) *The Quarterly Journal of Economics* pp.444-464; H. Myint, 'The Gains from International Trade and the Backward Countries' (1954-1955) 22 (2) *The Review of Economic Studies*, pp.129-142; and P.J. Drake, 'Natural Resources Versus Foreign Borrowing in Economic Development' (1972) 82 (327) *The Economic Journal* pp.951-962.

[48] Stiglitz, above n 21, at p.128.

[49] Chapter 7 demonstrates how the RCT is heard too loudly. At the University of Papua New Guinea in the 1990s, I recall that any mention of Marxist or neo-Marxist ideas represented in underdevelopment economics was treated as a forbidden subject, so no one talked about it. This is not so with the RCT.

with minimal state intervention and dependence on the free market to restore the exchange rate at equilibrium level whenever sharp movements in international mineral prices disrupt it.[50] The critical role of a government is to neutralise the unpredictable price fluctuations by maintaining (1) surplus budget and (2) stabilisation funds, among other policy options.[51]

These two orthodox macroeconomic policies are based on the need of a government to resist the temptation to overspend windfall revenue flows from natural resources, especially to mortgage future natural resource revenues to secure more loans.[52] Failing to maintain balanced budget could lead to increased foreign borrowing, which can appreciate the exchange rate and hence contribute to the Dutch disease.[53] The economic experiences of Indonesia, which did not borrow, and Mexico, which did, during the oil booms in the 1970s, are used to support the argument against foreign borrowing by mortgaging actual and prospective resource revenue flows.[54] Buffie and Krause provide a useful analysis of the Mexican experience.[55] They show that after discovery of large oil reserves in 1977, the Mexican government substantially increased its expenditures. Most of the expenditures 'had gone into recurrent expenditures, which had risen from 22% of GDP in 1977 to 36% in 1982. Public expenditure on capital accumulation did not

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50 Auty, *Sustaining Development in Mineral Economies*, above n11, at p.22.

51 Stevens, above n1, at p.20.

52 Norio Unsui, 'Dutch Disease and Policy Adjustment to the Oil Boom: A Comparative Study of Indonesia and Mexico' (1997) 23 (4) *Resources Policy* p.151, at p.157.

53 Unsui, ibid. According to Arman Mansoorian, however, heavy external borrowing actually leads to depreciation: see Arman Mansoorian, 'Resource Discoveries and 'Excessive' External Borrowing', (1991) 101 (409) *The Economic Journal* pp.1497-1509.

54 Unsui, above n52.

55 E. F. Buffie and A. S. Krause, 'Mexico 1958-86: From Stabilizing Development to the Debt Crisis' in Jeffrey. Sachs (ed), *Developing Country Debt and the World Economy, NBER Project Report* (1989).

rise by nearly as much; it rose from 7.5% of GDP in 1977 to only 10.6% in 1982.'[56] Buffie and Krause then demonstrate that insufficient government savings and huge foreign debt was one of the main causes of Mexico's economic woes in 1982.[57] Mexico's total debt rose from $27.9 million in 1977 to $87.6 billion in 1982. Mexico's debt increased because:

> During the oil boom, the Mexican government spent most of the oil revenues in promoting oil production by investing heavily in the state oil company, PEMEX. This implies that the necessity to protect the tradable sector during the oil boom was to a large extent neglected by the Mexican government. This is clearly the reverse of what should have been done to avoid the effects of the Dutch disease.[58]

In contrast, Indonesia escaped such an economic calamity because:

> the Indonesian budget expenditure was more balanced: spent on infrastructure, social services, agriculture, and industry as well. The oil revenues went to agriculture and industry, that is, tradable sectors to strengthen their production. The most arresting feature is found in her agricultural policy… The Indonesian government consistently put high priority on agricultural development, especially rice production, with considerable emphasis on research and extension, investment in irrigation, and subsidization of fertilizer. With the arrival of the Green Revolution, the Indonesian government spent the oil revenues on encouraging the intensive use of fertilizer in rice production, on which the new high-yielding rice varieties are very dependent. … The fertilizer subsidy and price support of rice improved the fertilizer/rice price ratio, which gave a strong incentive for farmers to increase their fertilizer use. As a result, Indonesia achieved self-sufficiency in rice production in the mid 1980s.[59]

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[56] Masoorian, above n53, at p.1497.
[57] Buffie and Krause, above n55, at p.155.
[58] Unsui, above, n52, at p.156.
[59] Id., at pp.156-57.

The difference between the two countries' policies is the *current* and *capital investment* expenditure. Mexico spent most of its oil revenue on *recurrent expenditure*, whereas Indonesia maintained a high *investment capital expenditure*. 'This simple fact suggests that the oil revenue in Indonesia was spent more on investment purposes compared with Mexico.'[60] For this reason, many researchers, particularly from the World Bank, support the view that Indonesia has managed its oil revenue well.[61]

Eifert, Gelb and Tallroth argue that although it would appear that the essentials of good management of oil revenues are the same as those for good budget management in general, it is not. Some issues are more important and critical for oil exporters. 'These include how much to save for future generations, how to deal with uncertain revenues and avoid "boom-bust" cycles, and how to ensure that spending is of high quality, whether in the form of large investment projects, public consumption or subsidies.'[62] They believe that high quality spending mainly prevents rent-seeking, patronage and waste. Such a policy has been recently prescribed to Iraq,[63] oil-exporting countries of the Mediterranean region,[64] Russia,[65] and other resource-rich regions in the periphery.[66]

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60 Id., at p.156.

61 Philip Daniel, *Oil Revenues and Fiscal Policy* (2007), at http://povertyenvironment.net/files/CASE%20Indonesia.pdf; <accessed 20.09.07>. See also World Bank, *World Development Report 2005, A Better Investment Climate for Everyone* (2004).

62 Benn Eifert, Alan Gelb and Nils Borje Tallroth, 'The Political Economy of Fiscal Policy and Economic Management in Oil Exporting Countries' (World Bank Policy Research Working Paper 2899, The World Bank, Washington D.C., 2002) p2.

63 The World Bank, *Part III. Improving Public Management and Accountability, Chapter 5. Managing Oil Revenues* at http://siteresources.worldbank.org/IRFFI/Resources/Iraqch5-final.pdf, <Accessed 20.09.07>.

64 Michael Sturm and Francois Gurtner, 'Fiscal Policy in Mediterranean Countries: Developments, Structures and Implications for Monetary Policy' (Occasional Paper Series No. 69, European Central Bank, Frankfurt, Germany 2007).

65 OECD, *Economic Survey of the Russian Federation 2006: Fiscal Policy: The Principal Tool for Macroeconomic Management*, online at http://www.oecd.org/dataoecd/28/22/37733537.pdf <Accessed 20.09.07>.

Concerning the 'boom-bust' cycle and the need to avoid exchange rate appreciation, orthodox economics offer several options. One option is to abandon a fixed exchange rate policy and float the local currency for the market to determine its true value when there is domestic inflation. Another option is currency devaluation. But Unsui argues that without good demand management policies such as the accumulation of budget surpluses, devaluation has no effect on the real exchange rate.[67] However, with balanced budgets and generous savings rate, a resource-rich country can, like Botswana, Chile, Indonesia and Malaysia who have escaped the curse, experience depreciation of real exchange rates.[68] Auty observes that the exchange rate issue used to be controversial but neoliberal hegemony since the 1990s has ensured 'some sort of consensus concerning the appropriate macroeconomic responses to mineral economies.'[69] The neoliberal orthodoxy calls for free markets to restore the exchange rate equilibrium. Since central banks have been made independent from government interference to determine macroeconomic policies to control inflation, interest rates, currency fluctuations, and other financial de-regulation policies as part of the general monetary policy, free market economics dominate today.[70]

While structuralist theory recommended downstream processing of natural resources to deal with this issue, neoliberal economists offers the above macroeconomic policy solutions. Under both theories the government still plays a critical role: under a

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66 Eifert, Gelb and Tallbroth, above, n51; also Auty, above n39, Part II – pp.73-124.
67 Unsui, above n40, at p.155.
68 Steven, above n1, at p.20.
69 Auty, above n11, at p.22.
70 See Ian MacFarlane, 'Geography, Resources or Institutions?' (A paper delivered to 'The Bottom Line' Luncheon in Melbourne, 25 August 2004).

neoliberal regime, the role of government is to remove any restrictions on free market capitalism in order to let the market cause economic development and social change, while under structuralism, government must be involved to improve market failures, build infrastructure, and encourage local businesses to assert economic independence.

IV. SAVINGS AND RESOURCE FUNDS

Orthodox economists not only recommend *surplus budget* to cause *savings*, but also recommend that the surplus budget should be saved in *stabilization funds* rather than committing them to *capital expenditure* as Indonesia did. One of the reasons for this policy, as mentioned above, is to stabilise public spending. That means a government must not increase its spending even if its revenue is more than budgeted for as a result of commodity booms. This policy is to prevent a situation where spending commitments cannot be kept and sustained when commodity prices collapse. As Eifert, Gelb and Tallroth elaborate:

> Rapid growth in public spending, which often follows oil price increases, reduces spending quality and introduces entitlements, including recurrent cost commitments, which are often not sustainable in the long run. Efficiency often suffers from a high proportion of unfinished projects as well as from capital investments that cannot be effectively used because of shortages of recurrent resources.[71]

Another reason for savings in stabilisation funds is to ensure sustainability for future generations. The third reason is to ensure quality government spending by preventing them from engaging in rent-seeking, corruption, patronage and wastage.

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[71] Eifert, Gelb and Tallroth, above n62, at pp.2-3.

Savings in *oil or mineral funds* have become popular under neoliberalism in recent times.[72] Savings in the form of *investment expenditure* on projects such as education to develop human capital, or on transport infrastructure to provide market access and reduce transportation costs in doing business, are not popular under neoliberalism. Under Keynesianism, however, developing countries have adopted this form of savings and became successful as we saw earlier in the case of Indonesia. Neoliberal economists and the resource curse theorists prefer savings in oil or mineral funds rather than investment expenditure. As we saw under the sterilisation policy above, orthodox economists assume that mineral and oil funds stabilize and cushion the effect of fluctuations in world commodity prices and exchange rates by supporting shortfalls in government budgets whereas capital expenditure cannot. The Norwegian *Government Petroleum Fund* is often held up as a good example in performing this type of macroeconomic role.

The Norwegian *Government Petroleum Fund*, now called *Government Pension Fund – Global*, was established by legislation[73] 'to facilitate government savings to fund the pension expenditure of the National Insurance Scheme, and to strengthen long-term considerations in the allocation of government petroleum revenues.'[74] The original macroeconomic policy objectives were price stabilisation to shield the national economy from international oil price volatility, and savings for sustainable use and management.

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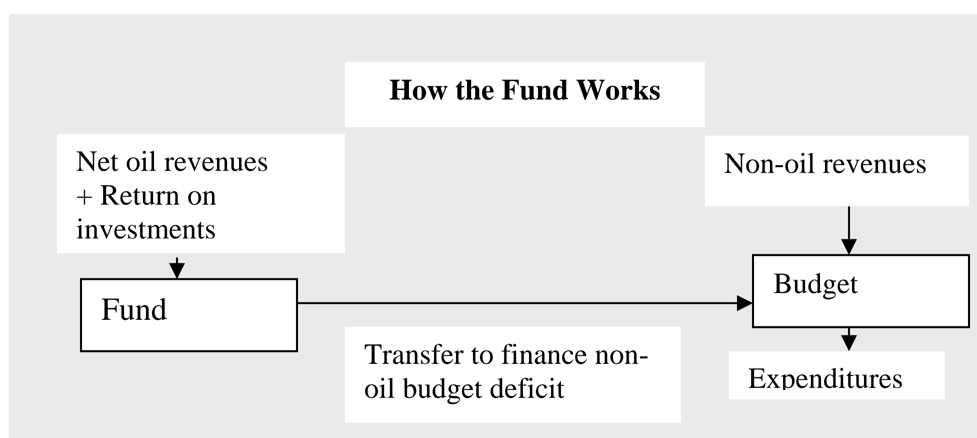
72 Modise D. Modise discusses other ways, 'Management of Mineral Revenues: The Botswana Experience' (Paper presented at the Workshop on Growth and Diversification in Mineral Economies organized by UNTAD in Cape Town, South Africa, 7-9 November 2000).

73 *Government Petroleum Fund Act* No.36 of 22 June 1990 (the Act). The 1990 Act has been superseded by *Government Pension Fund Act* No.123 of 2005, which came into effect on 1 January 2006. The latter Act amalgamates the *Government Petroleum Fund* and the *National Insurance Scheme Fund*. The merged fund is now called *Government Pension Fund – Global*.

74 Kristin Halvorsen (Norway's Finance Minister), *White Paper on the Government Pension Fund: Laying the Foundation for Good and Sustainable Return*, located at http://www.norges-bank.no/english/petroleum_fund/management/strategy.html.

An additional objective has been included to reflect government pension policies. Svein Gjedrem, the governor of Norges Bank who manages the fund, explains that the fund is designed to ensure that petroleum revenues are used not only by the current generation but also by future generations.[75] The two purposes of the Fund are to (1) shield the economy from fluctuations in prices and extraction rates in the petroleum sector, and (2) to act as a savings fund.[76] A significant part of the petroleum revenue in the Fund is invested abroad to a capital outflow that offsets the impact of large and varying foreign exchange inflows from the petroleum sector on the Norwegian krone exchange rate.[77] The Fund is fully integrated with the fiscal budget in order to facilitate growth in the fund being a reflection of the State's actual accumulation of financial assets. To avoid administrative costs and bureaucratic baggage, the Fund does not have its own Executive Board or administrative staff; it is managed by Norway's central bank.[78]

Table 5.1 below shows how the Fund works.



Source: Ministry of Finance.[79]

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75 Svein Gjedrem, 'The Long-term investment strategy of the Norwegian Petroleum Fund' (Address at the Argentum Conference, 30 September 2004).

76 Ibid.

77 Halvorsen, above n74.

78 Ibid.

79 Tore Eriksen, *The Norwegian Petroleum Sector and the Government Pension Fund Global*, (June 2006), at p.8, available online at

The Fund had no capital assets until 1996, when the government was able to transfer NOK 2 billion (2 billion Norwegian kroner) after the central government's account for 1995 showed a surplus for that amount. Since then, the central government's accounts have shown a surplus each year and capital equivalent to the surplus projected by the Ministry of Finance has been transferred to the Fund.[80] Between 1995 and 2003, a total of NOK 796 billion was transferred to the Petroleum Fund. By 2004, the Fund had about US$157.7 billion.[81] By the end of 2005 the Fund had risen to US$210 billion, which amounts to 99 percent of Norway's GDP (excluding petroleum activities).[82] Since the merger with the pension fund, the Fund has become the second largest Fund in the world, and the first in the rest of the European Economic Community (EEC) with a total asset value of about US$300 billion by the end of 2006.[83]

The Fund is under the management of the Finance Ministry. The Finance Ministry then delegated its management responsibilities to the Norges Bank, whilst retaining powers of control and oversight over the performance of the Fund. The Norges Bank, in its turn, set up a separate investment management called the Norges Bank Investment Management (NBIM). The NBIM in its turn relies on professional investment companies from selected countries around the world to manage the equity portfolio of the Fund. According to the investment guidelines or what is called *benchmark portfolio* provided by the Finance Ministry, 40 percent of the Fund must be invested in equities and 60

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http://www.regjeringen.no/upload/FIN/Statens%20pensjonsfond/The_Norwegian_Petroleum_Sector_te.pdf <Accessed 24.09.07>

[80] The Government Petroleum Fund Annual Report 2003, available at http://www.norges-bank.no/Pages/Report____47708.aspx#4 <Accessed 24.09.07>.

[81] News From Norway, *Norway Oil Fund Near Trillion Crown Mark* (first published 23 May 2004), at http://www.aftenposten.no/english/business/article917808.ece. <Accessed 24.09.07>.

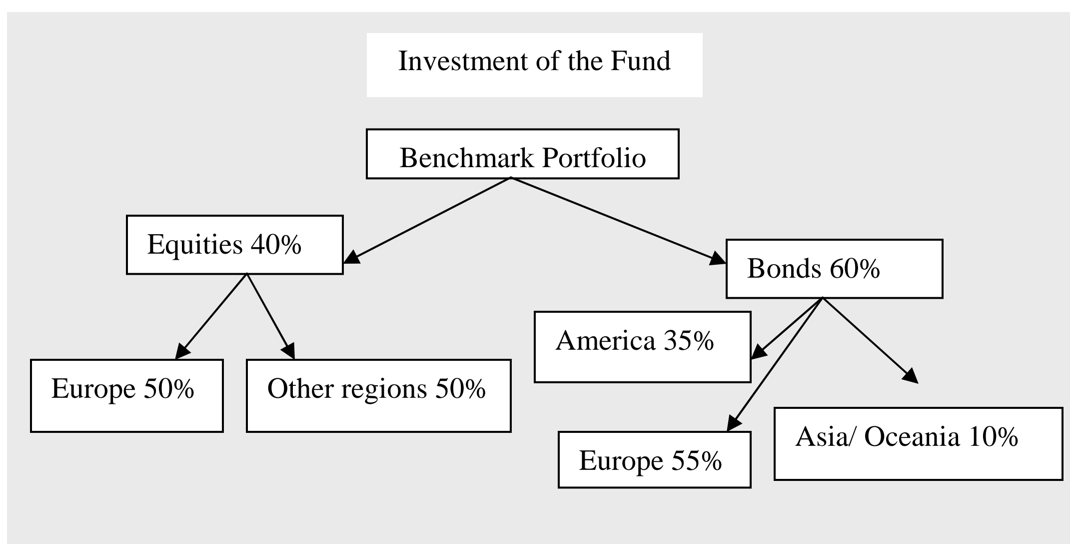
[82] Eriksen, above n79, at p.7.

[83] See http://www.pensionfundsonline.co.uk/statistics/statistics.aspx <Accessed 24.09.07>.

percent in bonds, treasury bills and term deposits – fixed income instruments. The equity component must be invested as follows: 50 percent equities listed in European exchanges and 50 percent in the Americas, Africa, Asia and Oceania. The 60 percent invested in fixed income instruments must be apportioned as follows: 55 percent in instruments issued in European currencies, 35 percent in American currencies, and 10 percent in Asian and other currencies.

Pursuant to the governing legislation, the Storting approved a guideline for the use of petroleum revenues which specified that only 4 percent, or the expected annual real return on the invested funds, would be used. If the Fund performed better than 4 percent, then the difference accumulates towards the capital of the Fund. This fiscal rule is to ensure the use of revenues in the Norwegian economy at a level that can be sustained over time.

Table 5.2



Source: Ministry of Finance[84]

[84] Eriksen, above n79, at p.14.

Many countries, especially newly independent and transitional countries, have adopted the Norwegian model to save their oil revenues. Timor-Leste, which became the world's newest nation on 20 May 2002,[85] is one of those countries. As foreshadowed in Section 139 of its *Constitution*, which provides that in order for fair, equitable and sustainable use of resource revenues, it is mandatory for the establishment of financial reserves in accordance with law, the *Petroleum Fund Act* 2005 was enacted by Parliament to establish a Petroleum Fund. The purposes as well as the management structure of the Fund are similar to that of Norway. Like Norway's, the Fund's assets comprise all petroleum revenue accruing to the government plus returns on the investments. The Fund's assets must be managed in the highest standard of transparency.[86] Transparency is to be ensured through proper keeping of records and accounts which must be internally audited every six months,[87] and through independent auditing by an internationally recognised accounting firm selected and appointed by the government.[88] The assets of the Fund must not be encumbered or mortgaged.[89] The Fund must submit its annual report to Parliament for each fiscal year.[90] Anyone failing to disclose or publicise information required by the Act could face a maximum of three years imprisonment upon conviction.[91] Similarly, anyone who supplies misleading information could be

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[85] UNHCR, *Country Operation Plan: Overview: Timor-Leste 2006* online at http://www.unhcr.org/home/RSDCOI/4332c68a2.pdf. <Accessed 23.10.07>. One source says Timor-Leste became the world's newest nation in 2001: see http://ip.alp.org.au/download/now/timor_leste_political_parties_and_groupings_2nd_edition.pdf. <Accessed 23.10.07>.

[86] Article 32, *Petroleum Fund Act* 2005.

[87] Article 22, *Petroleum Fund Act* 2005.

[88] Article 34, *Petroleum Fund Act* 2005.

[89] Article 20, *Petroleum Fund Act* 2005.

[90] Article 23, *Petroleum Fund Act* 2005.

[91] Article 38, *Petroleum Fund Act* 2005.

imprisoned for three years upon conviction.[92] Further, any aggrieved person can lodge complaints with the Ombudsman for Human Rights and Justice for any matter covered by the Act.[93]

There are other oil and mineral funds that are beyond the scope of this chapter to review.[94] Just to mention a few of these funds, the Alaska Permanent Fund (APF) is perhaps the oldest government savings fund.[95] Alberta Heritage Savings Trust Fund of Canada is another.[96] In the 1990s, oil-rich transitional economies like Russia, Azerbaijan and Kazakhstan also established oil funds. The *Russian Oil Stabilization Fund* (ROSF) was established in January 2004. The ROSF is modeled after the Norwegian oil fund to reduce the vulnerability of the state budget to the volatility of world oil prices (stabilisation function), and to sterilise the impact of oil-related foreign exchange inflows on the money supply and inflation (sterilisation function).[97] It has assets estimated at US$90 billion by the beginning of 2007.[98] The fund grew at the back of rising world oil prices. Russia has the world's second largest oil reserve after Saudi Arabia. Economic conservatives are very cautious that Russia must do all things necessary to avoid the

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92 Article 39, *Petroleum Fund Act* 2005.

93 Article 45, *Petroleum Fund Act* 2005.

94 For the other funds, see Robert Bacon and Silvana Tordo, *Experiences with Oil Funds: Institutional and Financial Aspects* (Washington D.C.: The World Bank Group, June 2006). See also Carolyn Fischer, *International Experience with Benefit-Sharing Instruments for Extractive Resources* (Washington D.C.: Resources for the Future, May 2007). A comprehensive list worldwide can be found at http://www.iie.com/publications/papers/truman1107tables.pdf. <Accessed 23.01.09>.

95 Alanna Hartzok, *The Alaska Permanent Fund: A Model of Resource Rents for Public Investment and Citizen Dividends* - Earth Rights Institute at http://www.earthrights.net/docs/alaska.html. <Accessed 23.01.09>.

96 See A. F. Collins, 'The Alberta Heritage Savings Trust Fund: An Overview of the Issues' (1980) 6 (Supplement) *Canadian Policy Journal* pp.158-165.

97 Vasily Astrov, 'The Russian Oil Fund as a Tool of Stabilization and Sterilization' 1/07 *Focus* pp.167-176, online at http://www.oenb.at/de/img/feei_2007_1_astrov_tcm14-58446.pdf <Accessed 01.10.07>.

98 *International Herald Tribune* and *The Associated Press,* 'Briefing: Russia's Oil Fund Surges Close to $90 Million' (Wednesday, 10 January 2007) at http://www.iht.com/bin <Accessed 02.10.07>.

resource curse.[99] Andrei Illarionove, then economic advisor of President Vladimir Putin, prefers to describe the curse as 'Venezuelaization', referring to Venezuela's description of its resource curse experience as drowning in 'the devil's excrement'.[100]

The Republic of Azerbaijan established the *State Oil Fund* (SOF) in December 1999. The purpose of the fund is to ensure effective collection and management of foreign currency generated from oil and gas projects.[101] Two major aims of the fund are, firstly, to avoid political pressure to spend oil wealth rapidly and inefficiently, and secondly, to prop up budget deficits.[102] For Kazakhstan, which established the *National Fund for the Republic of Kazakhstan* (NFRK) in August 2000, the two main aims are to maintain fiscal (expenditure and tax) discipline, and to save a portion of the oil income for future generations.[103]

Not only resource-rich countries but also resource-poor countries in many parts of the world have established government funds[104] to stabilise and insulate their budgets and

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[99] Organization for Economic Co-operation and Development (OECD), *Economic Survey of the Russian Federation 2006* online at http://www.oecd.org/documents/ <Accessed 02.10.07>.

[100] *BusinessWeek*, 'Russia: The Curse of $50 A Barrel', online at http://www.businessweek.com/ <Accessed 02.10.07>. A famous Venezuelan, Juan Pablo Perez Alfonzo, referred to oil as the devil's excrement.

[101] John Wakeman-Linn, Paul Mathieu and Bert van Selm, *Oil Funds in Transition Economies: Revenue Management. Azerbaijan and `Kazakhstan* online at http://www.earthinstitute.columbia.edu/cgsd/STP/Oil%20revenue%20management/General%20Oil%20Documents/Azerbaidjan_and_Kazakhstan/Political%20Economy%20of%20Oil%20Funds%20PPT%20JohnWakeman-Linn.pdf <Accessed 01.10.07>.

[102] Christian E. Petersen and Nina Budina, 'Governance Framework of Oil Funds: Azerbaijan and Kazakhstan', (Washington DC: The World Bank, undated) online at http://www.earthinstitute.columbia.edu/.../**Governance**%20of%20**Oil**%20**Funds**%20ChristianPetersen.pdf <Accessed 01.10.09>.

[103] Ibid.

[104] For an overview of the worldwide government funds, see Steffen Kem, 'Sovereign Wealth Funds – State Investments on the Rise', (10 September 2007) *Current Issues* of the Deutsche Bank Research, available online at http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000215270.pdf <Accessed 01.10.07>.

economies from exchange rate and commodity price volatility, help monetary authorities sterilise unwanted liquidity, and accumulate capital in savings for future generations, or use it on economic and social development (investment expenditure).[105] Singapore provides a good example. The *Government of Singapore Investment Corporation* (GIC) is a global investment management company established by the Government of Singapore in 1981 to manage Singapore's foreign reserves. With a network of seven overseas offices in key financial capitals around the world, GIC invests internationally in equities, fixed income, money market instruments, real estate and special investments. Since its inception, it has grown from a few billion dollars fund to well above US$100 billion investment company today. With a portfolio of this size, the GIC is now considered amongst the world's largest fund management companies. GIC's objective is to achieve good long-term returns on assets under its management, and to preserve and enhance Singapore's reserves.[106]

South Korea adopted Singapore's model in establishing *Korea Investment Corporation* (KIC) by legislation.[107] The purpose of the legislation is to conduct effective management of government assets and contribute to the development of the Korean financial industry.[108] Initial funds for KIC came from the Bank of Korea, which

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[105] Andrew Rozanov, 'Who Holds the Wealth of Nations?' (August 2005) *State Street Global Advisors*, online at http://www.ssga.com/library/esps/Who_Holds_Wealth_of_Nations_Andrew_Rozanov_8.15.05REVCCRI1145995576.pdf <Accessed 31.09.07>

[106] This information is based on materials provided at the official web site of GIC located at http://www.gic.com.sg/aboutus.htm <Accessed 02.10.07>.

[107] The *Korea Investment Corporation Act* No. 7393 – adopted on 24 March 2005, available online at http://kic.go.kr/en/images/in/01.KICACT.pdf Accessed 02.10.07>.

[108] Article 1, *Korea Investment Act* 2005 (KIA).

contributed $17 billion, and the Ministry of Finance, which provided $3 billion, to provide a total of $20 billion.[109] Since its launch on 1 July 2001, the first investment was made in November 2006 by placing part of the fund with external fund managers, while part of it would be directly invested during the second half of the year (2007).[110]

In March 2007, China announced that it would invest part of its huge US$1.2 trillion foreign exchange reserves in a government fund. According to the WorldNews Network online, China formally launched *China Investment Corporation* (CIC) on Saturday 29 September 2007, in which to invest US$200 billion out of its reserves, creating one of the world's richest government funds.[111]

The growing number of peripheral government saving funds, like China's $200 billion investment fund, is threatening the financial hegemony of the core economies. Financial institutions such as Merrill Lynch and Morgan Stanley are concerned that, buoyed by recent rises in oil prices, peripheral government funds which they estimate to be currently at $1.9 trillion in assets would surge to about $7.9 trillion by 2011, and swell to $12

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[109] Park Seung and Han Duck-soo, *What is the Korean Investment Corporation?* online at http://www.glcwatch.com/Default.aspx?tapid=88552 <Accessed 02.10.07>.

[110] Serck-Joo Hong, 'Opportunities and Challenges in Sovereign Wealth Management' (Keynote Address at the Korean Capital Markets Congress 2007, Euromoney Conferences, held at Grand Hyatt, Seoul, on 15 May 2007) available online at http://www.kic.go.kr/program/include/print.jsp <Accessed 02.10.07>.

[111] Edwin M. Truman, 'The Management of China's International Reserves: China and a SWF Scoreboard' (Paper prepared for Conference on China's Exchange Rate Policy, Peterson Institute for International Economics, Washington D.C., 19 October 2007), online at http://www.petersoninstitute.org/publications/papers/truman1007.pdf. <Accessed 23.01.09>. See also *China Launches US$200 billion Government Investment Fund* located at http://article.wn.com/view/2007/09/29/China_launches_US200_billion_govt_investment_fund/?template=cheetah-article%2Fdisplayarticle.txt <Accessed 02 October 2007>.

trillion by 2015.[112] Politicians are also worried. Some U.S. politicians squawked when China's government fund bought non-controlling shares in private-equity giant Blackstone, and also when the government-owned Dubai Borse acquired a stake in the Nasdaq stock market.[113] According to *The Australian*, the G7 countries are planning to introduce "draconian" measures to control the activities of peripheral government investment funds.[114] By 20 October 2007, the then U.S. Treasury Secretary Henry Paulson had already directed the International Monetary Fund (IMF) to develop guidelines for the government investment funds. He 'argued that a set of best practices would help tamp down the potential for a protectionist backlash in countries where the fund invests.'[115]

The issue is not only financial or economic, but has also become political. Former U.S. Treasury Secretary Larry Summers bluntly declared that the issue is 'profound and goes to the nature of global capitalism.'[116] He argued that:

> The logic of the capitalist system depends on shares causing companies to act so as to maximize the value of their shares. …It is far from obvious that this will, over time, be the only motivation of governments as shareholders. They may want to see their national companies compete effectively, or to extract technology or to achieve influence. … Apart from the question of what foreign stakes would mean for companies, there is the

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[112] William L. Watts, *Sovereign-wealth funds too big to ignore: Government-run Fund Causing Heartburn in Financial Establishments* in *MatchWatch*, 20 October 2007, online at http://www.marketwatch.com/news/story/sovereign-wealth-funds-too-big-ignore/story.aspx?guid=%7B306F9A57-55FD-4B8C-AA44-F1F9514ECF37%7D&dist=hplatest. <Accessed 24.10.07>.

[113] Ibid.

[114] Florence Chong, ''Sovereign Funds' War Chest Alarm G7' in *The Australian* (Sydney) Tuesday 16 October 2007, at p.23.

[115] Watts, above n112.

[116] Larry Summers, quoted Watts, above n112. See also Dan Denning, *The Daily Reckoning*, at http://www.dailyreckoning.com.au/sovereign-fuinds-eye-us-assets/2... <Accessed 26.10.07>.

> additional question of what they might mean for host governments. What about the day when a country joins some "coalition of the willing" and asks the US president to support a tax break for a company in which it has invested? Or when a decision has to be made about whether to bail out a company, much of whose debt is held by an ally's central bank?[117]

Jeffrey Garten added: 'These funds are going to have the ability to buy any global company, to create panic in markets if they move too precipitously, even to dwarf the political clout of international financial institutions. They can no longer be ignored.'[118] Richard Portes reported that:

> Sovereign wealth funds are politically so hot now that they have competed successfully with the financial crisis for media attention during July and August [2007]. American Congressman and the German Chancellor propose heightened surveillance, and possibly restrictions on capital inflows from this particular source. Even advocates of financial openness like the *Financial Times* are seriously concerned about the activities of these behemoths.[119]

Portes is spot on to say this issue is politically hot. Evidence of this can be found on the World Wide Web, where several commentators have invoked Cold War memories to describe the assumed threat posed by government funds from developing countries. For example, Bill Bonner posted:

> While wages in the USA haven't risen in 30 years, in Asia they are going up about 10% per year. The Asians are making money…and getting richer. And in the process they are

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[117] Ibid.

[118] Quoted at Dani Rodrik's Weblog, at http://rodrik.typepad.com/dani_rodriks_weblog/2007/08/misplaced-... <Accessed 26.10.07>.

[119] Richard Portes, *Sovereign Wealth Funds* online at http://www.voxeu.org/index.php?q=node/636. <Accessed 26.10.07>.

> accumulating huge stacks of dollars. Many of those dollars end up in the new Sovereign Funds – immense private equity funds owned by government. Lenin said that capitalist would sell the ropes that he'd use to hang them. Well, the communist Chinese are ready for a buying spree. Currently, those funds have about US$2 trillion in them. They're expected to have about US$17 trillion by 2010 – enough to buy every publicly-listed company in America…with change left over.[120]

Some observers critiqued that:

> this concern is hogwash and is becoming an issue only because the new wealth in emerging-market nations aren't playing by the same rules that made G7 play the equivalent of sovereign-wealth funds in other nations. *The only difference between Sovereign Funds and the G7 system is that in the former politics might drive the investment decisions while in the latter, investment decisions drive politics.* The only thing that upsets the G7 countries is that the Sovereign Funds don't show the hypocrisy of the G7 system, the pretension of keeping the interests of the capitalists and that of the country separate.[121]

Dani Rodrik rebuts Summers above by arguing that the 'creation of sovereign wealth funds is an attempt to diversify from these low-return investments, not a strategy to increase ownership of U.S. and other assets further. Summers might as well have welcomed this trend by noting that, by his own admission, the global financial system depends on investors and traders acting so as to maximize their economic return.'[122] Although the G7 and the European Union do not want peripheral government funds to buy controlling shares in the developed world's financial institutions and multinational

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[120] Posted by Bill Bonner, on 22 October 2007, at *The Daily Reckoning*, online at http://www.dailyreckoning.com.au/china-swf/2007/10/22/. <Accessed 26.10.07>.

[121] Anonymous commentator, posted on the web page above n118. Emphasis added.

[122] Dani Rodrik on his weblog, at http://rodrik.typepad.com/dani_rodriks_weblog/2007/08/misplaced-... <Accessed 26.10.07>.

corporations, the current financial credit crisis might cause them to reconsider this position.

Despite these dissenting views, the IMF has already moved in to impose financial surveillance on member states in response to the call made by the G7 countries under the pretext that it is doing so in pursuance of its mandate to oversee global macroeconomic stability.[123] On 15 June 2007, the 24-member Executive Board of the IMF adopted a new decision replacing the *1977 Decision on Surveillance over Exchange Rate Policies* designed to monitor and implement bilateral surveillance under Article IV of its *Articles of Agreement*.[124] The new decision seeks to clarify and codify best practice:

- that country surveillance should be focused on assessing whether countries' policies promote *external stability*. That means that surveillance should mainly focus on exchange rate, monetary, fiscal, and financial policies and on an assessment of risks and vulnerabilities;
- what is and is not acceptable to the international community in terms of how countries run their *exchange rate policies*; and
- that surveillance is *a collaborative, candid, and evenhanded process* between the Fund and its members, that takes into account countries' specific circumstances and has a multilateral, medium term perspective.[125]

Some criticisms about the reaction and hypocritical stance of the IMF and the G7 countries in relation to the successful implementation of their policies to encourage

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[123] See *Statement by IMF Managing Director Rodrigo de Rato on IMF Executive Board Decision to Approve New Framework for Surveillance* at http://www.imf.org/external/np/sec/pr/2007/pr07137.htm. <Accessed 26.10.07>.

[124] IMF, *Factsheet – June 2007: IMF Surveillance – The 2007 Decision on Bilateral Surveillance online* at http://www.imf.org/external/np/exr/facts/surv07.htm. <Accessed 26.10.07>.

[125] IMF, *A Factsheet – October 2007: IMF Surveillance* online at http://www.imf.org/external/np/exr/facts/surv.htm. <Accessed 26.10.07>. Emphasis added.

developing countries to save are in order. First, when Wall Street caused *external instability*, as demonstrated with the destructive consequences of the 1997 Asian financial crisis and the 2008 world recession, the IMF and the G7 countries remained silent and did nothing to regulate their speculative activities, or even support any proposition for regulation. However, when it comes to sovereign wealth funds from developing countries, which have not yet caused any *external instability*, the IMF and the G7 countries are too quick to adopt surveillance measures over their investment movements. This hypocritical stance speaks loudly of the *dominance-dependence* economic warfare in international political economy rather than what neoliberal theorists might want us to believe in the operation of a smooth and 'free capital market' serving willing participants without government interference on behalf of the monopoly capitalists.

The IMF should promote these government funds because they have been established in line with its neoliberal macroeconomic policy prescription. Yet, it now seeks to curtail their diversification into investments in the industrialised countries. Why? How can one understand this hypocritical stand? According to John Perkins, the IMF and the World Bank are banks of the US and the G7 countries.[126] Therefore, these rich, powerful and industrialised countries use their banks to control and prevent peripheral government funds from threatening their global financial and political hegemony.

One wonders what peripheral countries are really supposed to do. On the one hand, peripheral countries are urged to save. On the other hand, when they are saving as

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[126] John Perkins, *The Secret History of the American Empire: Economic Hitman, Jackals, and the Truth About Global Corruption* (2007) p.3.

advised, their freedom to invest those savings in a manner that will maximize their returns is limited and controlled. Indeed, this makes what is implied more explicit – that is, that the periphery must not develop and prosper to the point where they can compete at the same level as the centre so as to threaten and challenge the centre's hegemonic power, prestige and privileged position.

V. ANALYTICAL COMMENTS

Four issues that emerge from the above review deserve some comments. The first issue relates to diversification. If one function of diversification is to expand government revenue sources, and the function of savings in funds is to meet budget shortfalls in times of commodity price falls, then the policy contravenes the neoliberal policy of privatisation. Government-owned corporations promise governments a diversified revenue source. Privatisation amounts to curtailing these diverse revenue sources. So, in the view of this thesis, the neoliberal prescription for savings in oil or mineral funds is not in fact to diversify government income or meet budget shortfalls during price falls, but rather to serve other unspoken purposes.

This thesis contends that one of the unspoken purposes, which is the second issue, is the concentration of finance capital that underdevelopment economics refers to. It is a fact that Third World oil or mineral funds end up in the First World financial institutions. These funds are then *recycled* back to the Third World in the form of loans or investment in natural resource extraction (among other forms of investment) causing further exploitation. The concept of *recycling the petrodollar flows* first coined by former U.S.

Secretary of State Henry Kissinger describes this strategy very well.[127] In response to the rising oil prices in the 1970s, the world's top financial and political elites orchestrated a strategy to allow dollars paid to petroleum exporting countries to flow back to their financial institutions, which then flowed back to the petroleum-producing countries in the form of loans, which not only set off the Third World debt crisis of the 1980s, but also destabilised their economies through the imposition of structural adjustment policies in the name of bailing these countries out of their economic woes.

Without considering these international political economy events, the resource curse theorists blame oil and mineral resource-rich developing countries for mismanaging their windfall gains. Then they recommend that their windfall gains be kept in oil or mineral funds, which serve the strategy of recycling petro dollars. While the rich are using this money saved by poor countries, badly-needed infrastructure does not get built or rehabilitated. Children die of starvation. Children do not go to school because school fees could not be paid. Hospitals run out of medicines. Workers remain underpaid.[128] This thesis hence impugns the assumption that savings in oil and mineral funds would solve the curse and cause economic growth. Instead, it is the view of this thesis that savings in funds serves the *recycling petrodollar* agenda rather than causing economic growth and combat poverty.

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[127] William R. Clark, *Petrodollar Warfare* (2005) p.21.

[128] This is based on the PNG experience. While the government was keeping a surplus of about K2 billion in the years 2002-2007 as recommended by the IMF, the World Bank and neoliberal advisors from donor agencies, real development in providing public goods and services has been neglected and thus deteriorated.

The third comment centres on the perceived threat to the 'national interests' of the rich industrialised countries posed by sovereign wealth funds (SWFs) of developing countries. If SWFs threaten national interests of the rich nations, do transnational corporations (TNCs) threaten national interests of the developing countries? If yes, then which of the two is more destructive and harmful? In the view of this thesis, SWFs are harmless compared to the power of TNCs from the rich industrialised nations. According to conservative estimates, the world's 2,000 TNCs in 2007 had annual sales or assets in access of $27 trillion.[129] Globalization has given borderless powers to these giant corporations to exert economic and social influence '*that are sometimes equal to or larger than those of states – and that are often divorced from the interests of states*.'[130] How can one compare the power of global corporations to the power of nation-states in the Third World? David Rothkopf[131] answers this question by looking at the economic wealth of the world's largest corporations in 2007, from which a summary is provided below:

- In 2007, global GDP was estimated to be $47 trillion.
- That same year, the top 250 companies in the world had combined sales in access of $14.87 trillion, equivalent to nearly a third of global GDP and an amount exceeding the GDP of the US or the EU ($13.20 trillion and $13.74 respectively).
- The top 100 companies had sales worth over $9.72 trillion.

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[129] David Rothkopf, *Superclass: The Global Power Elite and the World They Are Making* (2008) p.33, 35.
[130] Ibid. Emphasis added.
[131] David Rothkopf served as Deputy Under Secretary of Commerce for International Trade Policy in the Clinton Administration. Rothkopf came to the government after founding and serving as chairman and chief executive officer of International Media Partners, where he was editor and publisher of *CEO* magazine and *Emerging Markets* newspapers, and chairman of the CEO Institutes. He currently serves as Chairman of the National Strategic Investment Dialogue and as a member of the advisory boards of the U.S. Institute of Peace and the Johns Hopkins/Bloomberg School of Public Health.

- The combine sales of the top five companies – Wal-Mart, ExxonMobil, Royal Dutch Shell, BP, and General Motors – was nearly $1.5 trillion – larger than the GDP of all but seven countries.
- ExxonMobil's assets are bigger than those of Saudi Arabia (the world's twenty-fifth largest economy).
- Wal-Mart ranks between Indonesia and Poland.
- General Motors tops Thailand.[132]

As Rothkopf argues: '*Indeed, given the scope and influence wielded by these companies – their potential effect on other industries and companies, their global networks of employees and shareholders – you might argue that they are even more powerful than countries of comparable size*.'[133]

Of the world's 106 largest corporations, 53 are based in the EU while 38 are in the U.S. and eight in Japan.[134] These corporations generally influence government. For instance, private corporate sponsors fund political elections in the U.S. and other industrialised countries.[135] Politicians, in turn, cut corporate taxes, provide subsidies, pass anti-dumping laws and set up trade barriers and other policies that promote corporate interests.[136] Despite this relationship between politics and 'big business' and the

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132 Ibid.
133 Id., 34. Emphasis added.
134 Ibid.
135 Lindsay Renick Mayer, *Power Players: Despite Industry Funds, Frank Cracks Down on Industry Players* dated 22 January 2009, online at http://www.opensecrets.org/news/2009/01/power-players-despite-industry.html. <Accessed 24.01.09>. Mayer provides sources of funds of many prominent US politicians including President Obama.
136 Monica Prasad, in *The Politics of Free Market* (2006) provides how 'big business' in America influenced the Reagan administration to cut corporate tax.

enormous power concentrated in the corporations against poor people in the Third World, the IMF, the EU and the U.S. feel threatened by SWFs. In other words, it is okay for the military-industrial complex to threaten and control the extractive industries and economies of developing countries but no corporation from a developing country must establish an influential market niche in the developed countries. In the view of this thesis, the fear of SWFs is hypocritical and unfounded. Transnational corporations indeed contribute to the resource curse and deserve to be properly regulated instead of giving them free reign as they have been allowed to do under the globalized neoliberal regime.

Finally, modernisation theory identified that private corporations cannot freely perform the role of government in providing infrastructure, education and telecommunication in order to cause capital accumulation in developing countries.[137] If money is saved, who will provide infrastructure services to the public? Private corporations will not. Neoliberal discourse on the RCT is silent on this issue. Indonesia succeeded because the government invested in capital, education and agriculture, instead of saving money in the banks of the rich nations for their use. The World Bank acknowledges that investment in capital is important, but the RCT fails to recommend this policy.

VI. CONCLUSION

From this analysis, this thesis submits that the structuralist policy of downstream processing and domestic manufacturing that the resource curse discourse rejects is in fact

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[137] Walt Whitman Rostow, *The Stages of Economic Growth: A Non-Communist Manifesto* (first published 1960, 1990 ed.) p.25.

the better policy solution to resolve the resource curse. The regressive growth in the late 1970s and early 1980s was due to international political economy factors beyond the control of resource-rich developing countries. In fact, it was the 'fault' of rich countries that caused commodity price fluctuation, or the international financial crisis as a result of removing the gold standard and the consequent rise in loan interest rates, or the setting up of trade barriers, and anti-dumping rules. The resource curse thesis fails to identify these exogenous causes, which are correctly identified by underdevelopment theory.

Therefore, in the view of this thesis the above neoliberal policies are not genuinely concerned in alleviating poverty and solving the resource curse in countries like PNG. When developing countries faithfully follow the prescribed diversification policy, they are faced with tariff barriers and claims of dumping. When they save in oil or mineral funds, they are viewed as threatening the hegemonic financial and political interests of the developed countries. What are developing countries like PNG supposed to do? Apart from the suggestion to leave natural resources in the ground, this thesis contends that other policies present one-sided views designed to exacerbate the resource curse rather than to solve it, even if such a consequence is unintended.

CHAPTER SIX

NEOLIBERAL RESCUE PLAN: FROM FREE TRADE TO GOOD INSTITUTIONS TO TRANSPARENCY AND GOOD GOVERNANCE

INTRODUCTION

This chapter examines the other four orthodox policies proffered to solve the resource curse. Section I examines the open trade policy; Section II takes a closer look at good institutions; Section III explores transparency and good governance measures to solve the curse; and Section IV examines good investment policies and political reforms. The last section provides a conclusion. As in the previous chapter, this chapter entails both the theoretical and practical aspects of these policies. Discussions involve examination of arguments for and against the policies with references to specific examples. As argued in Chapter Five, this chapter will also argue that these neoliberal policies will not solve the resource curse or underdevelopment in Papua New Guinea (PNG).

I. OPEN TRADE

From Adam Smith[1] and David Ricardo[2] to the present, orthodox development economists believe that trade is critical for economic growth and development.[3] Trade advocates genuinely believe that the way towards growth and eradication of peripheral poverty is

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[1] Adam Smith, *An Inquiry Into the Nature and Causes of the Wealth of Nations* (first published 1776, 1952 ed) p.190.

[2] David Ricardo, *The Principles of Political Economy and Taxation* (with an Introduction by Michael P. Forgarty, 1962) p.227.

[3] For instance, see Joseph E. Stiglitz and Andrew Charlton, 'Aid for Trade' (2006) 5 (2) *International Journal of Development Issues* pp.1-41; Richard M. Auty, *Economic Development and Industrial Policy: Korea, Brazil, Mexico, India and China*, (1994) see esp. ch.5; ----- Auty, *Sustaining Development in Mineral Economies: The Resource Curse Thesis* (1993); Mohsen Bahmani-Oskooee and Scott W. Hegerty, 'Exchange Rate Volatility and Trade Flows: A Review Article' (2007) 34 (3) *Journal of Economic Studies* pp.211-255.

open trade. David Nelson Smith's speech, given at the London Royal Commonwealth Society meeting in 1999, summarises this belief as follows:

> If we are going to combat poverty you need economic growth, which needs a strong agricultural sector to create a surplus. Growth requires that resources are switched out of agriculture so that they can be used in the rest of the economy. There is a strong correlation between economic growth and being open to trade. The cure for hunger is trade. Self-sufficiency doesn't work. Isolation has led to famines. Trade liberalization is the key to economic success. If it works for industry, it works for agriculture.[4]

Well said! But, as we saw in Chapter Five, the problem has been that markets in the G7 countries for peripheral exports, especially agricultural commodities, are closed.[5] As Joseph Stiglitz reveals:

> America has accused Mexico of dumping tomatoes, Colombia of dumping flowers, Chile and Norway of dumping salmon, China of dumping apple juice and honey. Today, Chilean wine growers worry that should they continue to be successful, California wine producers will demand that the United States impose dumping duties. Dumping duties deter entry and cast a pall over the entire market: any firm worries that, should it succeed in entering the American market with a new product, it will face dumping duties that will render it uncompetitive.[6]

Stiglitz goes on to describe how Vietnam's catfish export niche in the U.S., which captured about 20 percent of the U.S. catfish market and competed with the Mississippi catfish, was put out of competition by passing a law in Congress in response to electoral

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4 David Nelson Smith, Speech to a meeting at the Royal Commonwealth Society, London, 14 October 1999, quoted in John Madeley, H*ungry for Trade: How the Poor Pay for Free Trade* (2000) pp.47-48.

5 Ubong E. Effeh, 'Africa and the Multilateral Trading Regime: Re-examining the "Market Access" Mantra' (March 2008) 1 (1) *Journal of Politics and Law* pp.82-92.

6 Joseph Stiglitz, *Making Globalization Work: The Next Steps to Global Justice* (2006) p.91.

pressure from U.S. catfish producers who demanded that only U.S. catfish should be sold under the name 'catfish'. Vietnam withdrew and then re-entered the market under a different name, 'basa'. This time the 'basa' was not only displacing the Mississippi catfish market, but also fetching a higher price. The U.S. Congress responded by allegations of dumping, and imposed anti-dumping duties. Stiglitz points out that this is only one case of many others he had personally experienced.[7] So, Stiglitz observes that 'international trade is complex, with complicated rules that govern it, and these rules often constitute an important barrier to trade – sometimes deliberately so.'[8]

The resource curse thesis (RCT) does not delve into the practicalities, rules and complexities of international trade. It merely assumes that all preconditions for smooth trade exist in a free market without political constraints and barriers, and recommends open trade, which would usher in growth and prosperity. Allan Winters, after reviewing trade literature from the 1950s to the 1990s, argues that while trade liberalization certainly helps, first there must be *trading infrastructure* that facilitates exporters and importers to take advantage of open borders.[9] But if infrastructure is not in place, then open trade does not really help. Stiglitz agrees:

> It is easy for those in the advanced industrial countries to seize the opportunities that the opening up of markets in the developing countries afford – and they do so quickly. But there are many impediments facing those in the developing world. There is often a lack

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7 Id., at pp93-94.
8 Id., at p.94.
9 L. Allan Winters, 'Trade Policy as Development Policy: Building on Fifty Years' Experience' in John Toye (ed), *Trade and Development: Directions for the 21st Century* (2003) p.62, at p.73.

> of infrastructure to bring their goods to market, and it may take years for the goods they produce to meet the standards demanded by the advanced industrialized countries.[10]

Therefore, if we are to benefit from trade, then 'first we must reject two of the long-standing premises of trade liberalization: that trade liberalization automatically leads to more trade and growth, and that growth will automatically "trickle down" to benefit all. Neither is consistent with economic theory or historical experience.'[11]

Disregarding this evidence, open trade policies became prominent in the 1980s and 1990s as part of *structural adjustment policies* (SAPs) of the World Bank and the International Monetary Fund (IMF) as loan conditions to poor developing countries that sought their help.[12] The World Bank's 1991 *World Development Report: The Challenge of Development* is a synthesis of what the Bank's economists have learned from the past 40 years on economic growth and development.[13] In that report, the Bank's economists argue that despite their lack of natural resources, the Asian 'economic tigers' became successful because they adopted 'market-friendly' industrial policies, supporting Auty's argument we saw in Chapters Two and Five.[14] In their view, a market-friendly policy involves government intervention where the market fails. 'When markets and governments have worked in harness, the results have been spectacular, but when they

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[10] Stiglitz, above n6, at pp.62-63.

[11] Id., at pp.99-100.

[12] Kwame Akono, *Africa and IMF Conditionality* (2006); David A. McDonald and Greg Ruiters (eds), *The Age of Commodity: Water Privatization in Southern Africa* (2005); Paul Kwengwere, 'Africa's Hungry Are Fed Bad Policies: Incorrect IMF Advice and the US Push for Genetically Modified Food Only Worsen Existing Food Crises' (30 December 2004) *YaleGlobal*. Available at http://yaleglobal.yale.edu/display.article?id=5080. <Accessed 28.01.09>.

[13] The World Bank, *World Development Report: Challenge of Development* (1991).

[14] Id., at p.4.

have worked in opposition, the results have been disastrous.'[15] One way in which government and markets operated in opposition is with policies that retard competition and interfere with prices, deliberately or accidentally, which have very often proved counterproductive.[16] However, the World Bank report stresses that government intervention is required only in a *very limited* and *market-friendly* sense, which entail the following:

> Economic theory and practical experience suggest that interventions are likely to help provided they are market-friendly. That means:
>
> - *Intervene reluctantly*. Let markets work unless it is demonstrably better to step in. Certain actions involving public goods readily pass this test in principle because the private does not usually carry them out: spending on basic education, infrastructure, the relief of poverty, population control, and environmental protection. Certain other actions usually fail the test. For instance, it is usually a mistake for the state to carry out physical production, or to protect the domestic production of a good that can be imported more cheaply and whose local production offers few spillover benefits.
> - *Apply checks and balances*. Put interventions continually to the discipline of international and domestic markets.
> - *Intervene openly*. Make interventions simple, transparent and subject to rules rather than official discretion.[17]

As we saw in Chapter Three, the IMF supports the World Bank's position by trumpeting open trade as being the most important factor for economic growth than natural resources endowment or good institutions.[18]

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15 Id., at p.2.

16 Id., at p.4. The Bank does not talk about the tariff walls and anti-dumping rules of developed countries that retard competition.

17 Id., at p.5.

The 1991 World Bank Report has been severely criticized for downplaying the heavy government involvement in the industrial policy and planning of the fastest growing Asian countries like Japan and Korea.[19] The critics also point out that the Report ignores the demand side of economics, and simply concentrates on the supply side.[20] To such critics the World Bank counters: 'There is a growing consensus in empirical studies that greater openness to international trade has a positive effect on country per-capita income.'[21]

Is it true that there is a *growing consensus* in empirical studies that *greater openness* to international trade causes growth? This thesis begs to differ. Without doubt the World Bank is wrong to hold that there is a growing consensus in empirical studies because there is simply no such growing consensus. Instead, there is a growing doubt and disagreement on the question. As Juan Carlos Hallak and James Levinsohn who surveyed literature on this issue observe:

> Unfortunately, the attempts of a long literature looking at cross-country evidence have failed to provide a convincing answer. Several studies find an empirical connection between openness and growth, but they tend to suffer from basic methodological

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18 Rabah Arezki and Frederick van der Ploeg, 'Can the Natural Resource Curse Be Turned Into a Blessing? The Role of Trade Policies and Institutions' (IMF Working Paper No. WP/07/55, (Washington, D.C., 2007).

19 Ajit Singh, 'Openness and the Market Friendly Approach to Development: Learning the Right Lessons from Development Experience,' (1994) 22 (12) *World Development* pp.1811-1823.

20 Ibid.

21 The World Bank, 'Does More International Trade Openness Increase Poverty?' (Briefing Papers, by the Economic Policy Group and Development Economics Group of the Bank, part 2 of a four part series, Washington D.C., April 2000).

> shortcomings. Recent studies address these shortcomings but, once they do, they no longer find a robust empirical relationship between openness and growth.[22]

Hallak and Levinsohn then conclude:

> We learn that the question: "Does trade openness promote growth?" does not have a simple and unconditional answer. The final verdict on the impact of openness on growth may have to await further work using alternative datasets, variables, instruments, and empirical specifications. But the available body of empirical work shows that, once earlier methodological problems such as endogeneity and omitted variable bias are addressed, there is no robust evidence of a significant causal connection between openness and growth.

Other recent studies support this conclusion. For example, Howard Nye and Sanjay Reddy argue that 'the record of the effects of trade on growth and poverty appears to be considerably more mixed than claimed by Dollar and Kraay [of the World Bank].'[23] Similarly, Halit Yanikkaya observe that '*contrary to the conventional view on the growth effects of trade barriers, our estimation results show that trade barriers are positively and, in most specifications, significantly associated with growth, especially for developing countries and they are consistent with the findings of theoretical growth and development literature.*'[24]

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[22] Juan Carlos Hallak and James Levinson, 'Trade Policy as Development Policy? Evaluating the Globalization and Growth Debate' (National Bureau of Economic Research (NBER) Working Paper No. 10244, University of Michigan, 15 July 2004).

[23] Howard L. M. Nye and Sanjay G. Reddy, *Dollar and Kraay on "Trade, Growth and Poverty": A Critique* (undated), available online at http://www.networkideas.org/feathm/jun2002/Trade_Growth_Poverty.pdf. <Accessed 27.01.09>.

[24] Halit Yanikkaya, 'Trade Openness and Economic Growth: A Cross-Country Empirical Investigation' (October 2003) 72 *Journal of Development Economics* pp.57-89. Emphasis added.

From a practical standpoint, data from the United Nations Conference on Trade and Development (UNCTAD) shows that trade liberalization, and the dumping of farm products that inevitably follows, has generated a growing food deficit in least developing countries.[25] Likewise, the Food and Agriculture Organization (FAO) of the UN documents the experiences of 16 developing countries which implemented the World Trade Organization's Agreement on Agriculture (AoA) and other Uruguay Round (UR) agreements affecting agriculture by opening their markets to food imports from the developed countries on the promise that they would be reciprocated. But to their detriment, agricultural markets in the developed countries remained closed.[26] Although developing countries experienced import surges that damaged competing domestic farming sectors, they were largely unable to compensate by increasing their own export earnings, thus leaving them in a weakened, unbalanced and more dependent position.[27] Impressive foreign direct investment (FDI) through liberalized trade regimes did not improve their conditions as promised. For example, in the case of Mexico,

> Direct foreign investment rose from US$42 billion to US$62 billion in 1994 (under SAPs [i.e. structural adjustment programs]), and jumped once again to US$167 billion in 2000 (under NAFTA [i.e. North American Free Trade Agreement]). Export earnings increased similarly, from US$2.9 billion in 1980, to US$11 billion in 1994 and US$21 billion in 2001, though they fell off after that. On the other hand, these rather spectacular figures failed to make a dent in poverty, which actually grew over the same time periods.[28]

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[25] Peter Rosset, *Food is Different: Why We Must Get the WTO Out of Agriculture* (2006) p.54.
[26] Ibid.
[27] Xiaozhen Li and Wei Wang, 'WTO on Agriculture: A Developing Country Perspective' (June 2008) 2 (2) *Journal of Law and Politics* pp.19-24.
[28] Rosset, above n25., at p.55.

Empirical evidence like this shows that trade liberalization under neoliberalism expands the role of foreign direct investment. This thesis argues that neither FDI in the extractive sector nor open trade causes growth in developing countries like PNG. Instead, both policies cause underdevelopment and intensify dependency, especially in the case of PNG. Despite this result, neoliberal development theory trumpets open trade policies as the solution to the resource curse.

One can also see that the ideal mechanics of perfect market competition espoused here by the two financial institutions does not work in the real world as demonstrated by the interventionist policies of the Organization for Economic Cooperation and Development (OECD) countries in strangling foreign competition in their markets as seen in Chapter Five. Many economists provide compelling evidence demonstrating that countries that adopt neoliberal free trade regimes do not grow and prosper as promised.[29] Some of these dissenting views point to historical records, which show that the industrialised countries originally developed not by following open trade policies but autarkic policies, which neoliberals criticise today.[30] Notwithstanding the overwhelming historical evidence, autarkic policies or lack of openness are blamed for being among the most important causes of the resource curse. According to an economic historian, this hypocritical stand is deliberate because they know that '*free trade means monopolizing the resources and markets of weak nations*.'[31]

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[29] See for examples, J. W. Smith, *Economic Democracy: The Political Struggle for the 21st Century* (4th ed, 2005); Arthur MacEwan, *Neo-liberalism or Democracy? Economic Strategy, Markets, and Alternatives for the 21st Century* (1999).

[30] Ha-Joon Chang, *Kicking Away the Ladder: Development Strategy in Historical Perspective* (London: Anthem Press, 2003) provides the history of the autarkic policies of the industrialized world including that of the industrializing Asian countries.

[31] Smith, above n29, synopsis to his book at http://www.ied.info/books/ed/. <Accessed 07.05.08>.

II. GOOD INSTITUTIONS

Unlike the World Bank and the IMF, some other researchers favour *good institutions* as the most critical factor to cause growth. Rodrik, Subramanian and Rebbi have applied empirical analysis to test the claims of the three major factors for growth – geography (tropical climate, resource endowment, etc.), open trade, and institutions.[32] Based on the results of their model, they conclude: *'Most importantly, we find that the quality of institutions trumps everything else.'*[33] This is because institutions affect growth and development at the 'deepest' level. In their view, a sound institutional framework is crucial for sustained economic performance.[34] This conclusion supports the earlier study by Acemoglu, Johnson and Robinson of the settler mortality theory reviewed in Chapter Three.[35] Some generally accept both *open trade* and *sound institutions* as being equally important. As David Dollar and Aart Kraay observe: 'Countries with better institutions and countries that trade more grow faster. Countries with better institutions also tend to trade more.'[36]

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[32] Dani Rodrik, Arvind Subramanian and Francesco Trebbi, 'Institutions Rule: The Primacy of Institutions Over Geography and Integration in Economic Development' (2004) 9 *Journal of Economic Growth* pp.131-165.

[33] Id., at p.135. Italics supplied for emphasis.

[34] Ian J. Macfarlane, Governor of the Reserve Bank of Australia, 'Geography, Resources or Institutions?' (An address delivered at The Bottom Line Luncheon in Melbourne, 25 August 2004) at p4.

[35] Daren Acemoglu, Simon Johnson and James A. Robinson, 'The Colonial Origins of Comparative Development: An Empirical Investigation' (2001) 91 (5) *The American Economic Review* pp.1369-1401; Daren Acemoglu, Simon Johnson, James A. Robinson and Yunyong Thaicharoen, 'Institutional Causes, Macroeconomic Symptoms: Volatility, Crisis and Growth' (2003) 50 *Journal of Monetary Economics* pp.49-123.

[36] David Dollar and Aart Kraay, 'Institutions, Trade and Growth' (2003) 50 *Journal of Monetary Economics* p.133.

In Chapter Three, we saw that *good institutions* that cause growth comprise the rule of law,[37] property rights,[38] democratic government preferably with a parliamentary type,[39] and other democratic institutions that put constraints on politicians and on the exercise of executive power.[40] Edward Glaeser, by relying on North, who defined institutions as '*a set of rules, compliance procedures, and moral and ethical behavioral norms designed to constrain the behavior of individuals in the interest of maximizing the wealth of utility of principals*,'[41] emphasises the word *constrain* to point out that *constitutions* or *electoral rules* are good examples of institutions because they *constrain* public authorities. He then goes on to link up with Rodrik et al. to observe that *constraints* must not be *transitory* but *deep* and *permanent* in order for institutions to be good and meaningful for growth. So here we see that *deep* and *permanent* institutions that *constrain* government power as *good institutions* that can cause growth and prevent the resource curse.

After suggesting good institutions as a cure, none of the curse literature reviewed provides the details and mechanics of how good institutions originate, or how they can be developed, improved or reformed, and maintained. The studies do not even look at factors that prevent the emergence and sustenance of good institutions. The general impression one gets is that if a resource-rich developing country has quality institutions,

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[37] Ibid. See also Rodrik et al., above n32; Frederick van der Ploeg, 'Challenges and Opportunities for Resource Rich Economies' (European University Institute, University of Amsterdam, 25 April 2006), revised on 31 May 2007, and available online at http://www.iue.it/Personal/RickvanderPloeg/resource%20curse%20survey.pdf ,<Accessed 25.09.07>.

[38] Acemoglu et al, above n35a.

[39] Jorgen Juel Andersen and Silje Aslaksen, 'Constitution and the Resource Curse' (Working Paper Series No. 11/2006, Department of Economics, Norwegian University of Science and Technology, 4 September 2004).

[40] Acemoglu, Johnson, Robinson and Thaicharoen, above n35b.

[41] Douglas C. North, 'Structure and Change in Economic History' (1981) pp.201-202, quoted in Edward L. Glaesser, 'Do Institutions Cause Growth?' (2004) 9 *Journal of Economic Growth* p.271, at p.275. Emphasis added.

implicitly meaning democratic institutions and laws modeled on the advanced industrialised, democratic countries like the U.S. and Great Britain, then resource endowment would become a blessing. The only developing country that is repeatedly held up as the model for having escaped the curse because of its good institutions is Botswana.[42] Why does Botswana have *good institutions* that are absent in other resource-rich developing countries? According to a 2001 study by Acemoglu, Johnson and Robinson, since 'Botswana has had the highest rate of per-capita growth of any country in the world in the last 35 years,'[43] it probably has good *private property* institutions. The authors then explore why *good institutions of private property* arose in Botswana in the first place and not in other African countries. They propose five factors:

- Pre-colonial institutions in Botswana were relatively inclusive, placing constraints in political elites.
- Since British colonialism in Botswana was minimal, it did not destroy these institutions.
- Upon independence, it was in the interest of the political elites to maintain and strengthen the institution of private property.
- Since Botswana is very rich in diamonds, it has generated and continues to generate enough wealth for everyone, so no one wanted to disturb the status quo at the expense of 'rocking the boat'.

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[42] James Clark Leith, *Why Botswana Prospered* (2005) is a recent book that is among the few that explains why Botswana prospered.

[43] Daron Acemoglu, Simon Johnson and James A. Robinson, 'An African Success Story: Botswana' (EconPapers, available online at http://econpapers.repec.org/paper/cprceprdp/3219.htm <Accessed 08.10.09>).

- Key critical decisions of the post-independence leaders to reinforce the pre-colonial institutions and private property rights set the country on the right path for sustainable economic growth.[44]

The IMF's *Public Information Notice* on Botswana released in 2003 supports these propositions by adding that Botswana's 'success story has been widely attributed to sound economic policies, especially in managing its large diamond resources, and a commitment to democratic principles.'[45] An IMF study in 2006 endorses this view by interpreting *democratic principles* to mean *good governance* shown on the *Governance Research Indicator Country Snapshot* (GRICS) database developed by Kaufmann, Kraay and Mastruzzi.[46] To these authors, Botswana has enjoyed *good governance* by global and regional standards.[47] The *good governance* indicators (or *democratic principles* referred to in the 2003 IMF notice) are (1) voice and accountability, (2) political stability, (3) government effectiveness, (4) regulatory quality, (5) rule of law, and (6) control of corruption. Out of these six indicators of good governance, the 2006 IMF study argues that the first, third, fourth and sixth indicators are critical for resource-rich developing countries.[48] Botswana's institutions are sound because it satisfies these four indicators of good governance.[49] This IMF view on Botswana's *good institutions* to mean *good*

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44 Acemoglu et al., above n43, at p.20. This is an abbreviated version.
45 IMF, 'IMF Concludes 2003 Article IV Consultation with Botswana' (Public Information Notice (PIN) No. 04/78, 30 July 2004), available online at http://www.imf.org/external/np/sec/pn/2004/pn0478.htm <Accessed 25.09.07>.
46 D. Kaufmann, A. Kraay, and A. Mastruzzi, 'Governance Matters III: Governance Indicators for 1996-2002' (Washington, DC: The World Bank, 30 June 2003) draft available online at http://www.worldbank.org/wbi/governance/govdata2002/ <Accessed 27.09.07>.
47 Atsushi Iimi, 'Did Botswana Escape the Resource Curse?' (IMF working Paper WP/06/138), available online at http://www.sarpn.org.za/documents/d0002105/index.php <Accessed 23.04.07>.
48 Id., at pp.9-10.
49 Id., at pp.9-11.

governance as the reason for the country's avoidance of the resource curse has been popularised through the media to include *transparency* as the following 'Newshour with Jim Lehrer' reflects:

> Through good government policies, strong political leadership, and a sound long-term development plan, Botswana has seemingly avoided the effects of the resource curse, and provides quality public services such as education and healthcare for its citizens. Effective anti-corruption laws and high civil engagement has also forced representatives to be more transparent about how they are spending and distributing the country's natural resource wealth.[50]

Here, we must notice the subtle movement away from the first three factors of growth – *resource endowment*, *open trade* and *good institutions* – to *democratic principles*, which is interpreted to mean *good governance* and *transparency*. What do *transparency* and *good governance* have to do with economic growth and development? According to the Deputy Managing Director of the IMF, the IMF emphasizes *transparency* and *good governance* because:

> Transparency and accountability are critical for the efficient functioning of a modern economy and for fostering social well-being. In most societies, many powers are *delegated* to public authorities. Some assurance must then be provided to the *delegators*—that is, society at large—that this transfer of power is not only effective, but also not abused. Transparency ensures that information is available that can be used to measure the authorities' performance and to guard against any possible misuse of powers. In that sense, transparency serves to achieve accountability, which means that authorities can be held responsible for their actions. Without transparency and accountability, trust

[50] *Extra*, a Newshour with Jim Lehrer special for students, *Analysing the natural Resource Curse* online at http://www.pbs.org/newshour/extra <Accessed 28.09.07>.

> will be lacking between a government and those whom it governs. The result would be social instability and an environment that is less than conducive to economic growth.[51]

Nwako and Mpofu agree that *transparency* and *good governance* are the keys to Botwana's success because the control of funds is regulated by Botswana's constitution and elaborated in the *Finance and Audit Act*.[52] They believe that the main aspect of public finance management is the principle of good governance and public accountability that came about as a result of a foundation based on the principles of democracy. 'It is in pursuance of this accountability that there exist such structures as an Auditor General and an Ombudsman answerable to Parliament and the Parliamentary Accounts Committee, which reviews the financial statements as laid before Parliament by the minister responsible for finance.'[53]

From the forgoing analysis, one can say that neoliberal economists define *good institutions* as those institutions that promote *good governance* and *transparency*, and *good governance* and *transparency* mean *market-friendly* policies. Market-friendly policies in turn mean competition, open trade, de-regulation and less government intervention in the operations of free-market capitalism.[54] The conclusion is that

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[51] Agustín Carstens, 'The Role of Transparency and Accountability for Economic Development in Resource-rich Countries' (Address by Deputy Managing Director of the IMF, at the Regional Workshop on Transparency and Accountability in Resource Management in CEMAC Countries, Malabo, Equatorial Guinea, January 27, 2005), available online at http://www.imf.org/external/np/speeches/2005/012705.htm <Accessed 25.09.07>.

[52] Mompat Nwako and Pauline Mpofu, *Botswana: Getting the Basics Right*, posted on the web at http://www.africa-sbo.org/cabri/uploads/pdf/Chapter_1.pdf <Accessed 25.09.07>.

[53] Ibid.

[54] Anne O. Kruger, *Political Economy of Policy Reform in Developing Countries* (1993).

governments of resource-rich developing countries must adopt neoliberal and Washington Consensus policies to solve the resource curse or prevent it from occurring.

Some critiques of this policy prescription claim that the IMF itself is a hypocrite because it is preaching what it does not believe in and practice.[55] It is merely preaching '*an ideology, a particular lens through which it looks at the world.*'[56] Because of its restrictive and ideologically motivated narrow focus, the '*IMF makes assertions and predictions concerning its policies that are consistently proven wrong…*'[57] It imposes policies and causes structural changes overriding decisions of democratically elected leaders when it does not have the mandate.[58]

This thesis supports these arguments. For example, while accepting the assessment that Botswana has done well to avoid the resource curse, and praising the country's good institutions for that result, the IMF is still not satisfied, and urged Botswana to do more:

> Although the institutional system of the Botswana government appears robust, a *more transparent* and neutral regulatory agency could advance *efficient governance* further, with current virtues of *good governance* maintained. Indeed, the above evidence indicates that in resource management, regulatory quality – which calls on market-friendly competition policies and deregulation – is the most significant of all the dimensions of governance examined above.[59]

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55 See Joseph E. Stiglitz, 'Failure of the Fund: Rethinking the IMF Response' (2001) 23 (2) *Harvard International Review* p.14.

56 Id., at p16. Emphasis added.

57 Id., at p.17.

58 See Devesh Kapur and Moses Naime, 'The IMF and Democratic Governance' (Jan. 2005) 16 (1) *Journal of Democracy* pp.89-102.

59 Iimi, above n47, at p.23.

One can see here that the IMF is raising its standard one step higher from *transparency* and *good governance* to *a more transparent* and *efficient governance*. Is the IMF itself *transparent* and practices *good governance* and *efficient governance*? Does the IMF demand *transparency*, *good governance* and *efficient governance* from the G7 countries? This thesis argues that it does not. Why then does it insist on policies that neither the developed countries nor the IMF even observe? This thesis submits that such policies are demanded as a form of control to align good performing countries like Botswana to serve the interests of the monopoly capitalists represented by the IMF.

On the other hand, the IMF is blinded by Botswana's growth and oblivious to the plight of Botswana's poor. Robert Curry observes that the 'economic plight of Botwana's poor has worsened as a direct consequence of the mining sector's success.'[60] Curry points out that mineral-fueled economic expansion and modernisation '*has created an economic elite composed of a government bureaucracy and an emerging military "salariat", and a small group of corporation officials and managers*.'[61] The consequence is a widening gap between the few rich and the vast majority who are poor, which in turn '*could destabilize and threaten an African success story.*'[62] That being the complete view, the presentation of Botswana as an African success story, like the exaltation of competitive manufacturing in the fastest growing economies of East Asia, is a one-sided view from a

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[60] Robert L Curry, Jr., 'Poverty and Mass Unemployment in Mineral-rich Botswana' (1987) 46 (1) *American Journal of Economics and Sociology* pp.71-87.

[61] Ibid. Emphasis added.

[62] Ibid.

neoliberal ideological standpoint, which ignores questions of equitable distribution, social justice and labour exploitation.[63]

III. TRANSPARENCY AND GOOD GOVERNANCE

The institutional theory of the RCT assumes that good institutions characterized by *transparency* and *good governance* would reduce corruption and rent-seeking, cause economic growth and reduce poverty. Accordingly, the World Bank has adopted good governance, transparency and counter-corruption measures as central to its global mission to alleviate poverty. On its web page, the World Bank boasts:

> The World Bank views good governance and anti-corruption as central to its poverty alleviation mission. Nowadays, hundreds of governance and anti-corruption activities are taking place throughout the World Bank Group. They focus on internal organizational integrity, minimizing corruption on World Bank-funded projects, and assisting countries in improving governance and controlling corruption.[64]

Since the 1990s, Kaufmann and Kraay of the World Bank have published several papers on this issue severally and jointly and sometimes in collaboration with other researchers.[65] In one of his contributions in 2005, Kaufmann defines *governance* as

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[63] Some say that Botswana has an equitable distribution policy: see Theodore R. Valentine, 'Mineral-led Economic Growth, Drought Relief, and Incomes Policy: Income Distribution in Botswana Reconsidered' (Jan. 1993) 52 (1) *American Journal of Economics and Sociology* pp.31-49.

[64] On the front of its global governance and anti-corruption web page at http://worldbank.org/wbi/governance, (Accessed 03.10.07>.

[65] Daniel Kaufmann is the Director of Global Governance of the World Bank Institute, while Aart Kraay is the Lead Economist in the Development Research Group of the Bank. Kaufmann's publications are on this site: http://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=163813 . Kraay's publications can be accessed from http://econ.worldbank.org/external/default/main?authorMDK=123715&theSitePK=469372&pagePK=64214821&menuPK=64214916&piPK=64214942. <Both accessed 02.10.07>.

comprising three dimensions: (a) a political dimension, (2) an economic dimension and (3) an institutional respect dimension. He explains these dimensions as follows:

> We define *governance* as the traditions and institutions by which authority in a country is exercised for the common good. This includes:
>
> - the process by which those in authority are selected, monitored, and replaced (the political dimension);
> - the government's capacity to effectively formulate and manage its resources and implement sound policies (the economic dimension); and
> - the respect of citizens and the state for the country's institutions that govern economic and social interactions among them (the institutional respect dimension).[66]

These three dimensions of good governance are measured by six *Governance Indicators* which Kaufmann himself developed with Kraay and Mastruzzi.[67] Since these indicators are generally used to assess good governance, it is useful to enumerate them with their explanatory notes here:

(1) *Voice and Accountability* (VA) –measures the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media.

(2) *Political Stability and Absence of Violence* (PV) – measures the perceptions of the likelihood that a government will be destabilized or overthrown by

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[66] Daniel Kaufmann, *Myths and Realities of Governance and Corruption*, located at web page cited above, n65. This definition also appears in Kaufmann, Kraay and Pablo Zoido-Lobaton, 'Governance Matters' (Policy Working Research Paper No. 2196, October 1999) p.1.

[67] See above, n65.

unconstitutional or violent means, including domestic violence and terrorism.

(3) *Government Effectiveness* (GE) – measures the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.

(4) *Regulatory Quality (RQ)* – measures the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development (market-friendly policies).

(5) *Rule of Law* (RL) – measures the extent to which agents have confidence in and abide by the rule of society, and in particular the quality of contract enforcement, the police and the courts, as well as the likelihood of crime and violence.

(6) *Control of Corruption* (CC) – measures the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as 'capture' of the state by elites and private interests.[68]

Kaufmann et al explain that these six indicators are synthesised from over 350 variables on the perception of good governance drawn from 33 data sources provided by 30 different organizations. These indicators have been available since 1996. Kaufmann and others from the World Bank have concentrated on this issue since the 1990s and have revised previous works to narrow the margins of error or add on further information.

[68] Daniel Kaufmann, Aart Kraay and Massimo Mastruzzi, 'Governance Matters VI: Aggregate and Individual Governance Indicators 1996-2006' (World Bank Policy Research Paper 4280, Washington D.C., July 2007) pp.3-4.

Kaufmann et al acknowledge that 'measurement error is pervasive among all indicators of governance and institutional quality, including individual indicators as well as 'objective' or fact-based ones – if these are available at all.'[69] But they argue that it is better to have a useful summary of the large amount of information in various data from several sources to provide some sort of guideline or tool to assess the nature of good governance.

Kaufman et al acknowledge that there have been criticisms of the World Bank's good governance and anti-corruption crusade, but he responds to each of these challenges. First, there is a general perception that *good governance* and *anti-corruption* are one and the same. To them, that is not true. Governance is broad and entails the six *Governance Indicators* above. On the other hand, corruption traditionally means the 'abuse of public office for private gains', which is too narrow. It places too much emphasis on public office, and on the legality or otherwise of the act of public officers. But *good governance* attempts to include other aspects of corruption. The broader definition seeks to include actions where private agents are involved in unethical deals that may not be necessarily illegal. The new definition of corruption is ***'the privatization of public policy'***, *which captures undue influence exerted by private agents on public officers and public officers who allow themselves to be unduly influenced.* Using this broader definition, Kaufmann observes that not only developing countries but also a number of rich OECD countries fare rather poorly.[70]

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[69] Id., at pp.1-2.
[70] Id., at p82. Emphasis added.

By this definition, one could argue that since the World Bank and the IMF are engaged in *privatization of public policy* and exert undue influence on Third World governments through their loan conditionalities, they are involved in corruption, the very practice they seek to eradicate.

The second challenge Kaufman et al address is the argument that good governance and corruption cannot be measured. But Kaufman et al. argue that this is now possible with the adoption of the six Governance Indicators, even though they may not be entirely accurate. The third challenge is that lack of good governance and corruption are not very serious factors preventing good economic performance. While that is arguable, Kaufman et al. point out that studies indicate that the annual worldwide transactions that are tainted by corruption are estimated to be close to US$1 trillion, but taking the margin of error of this estimate, the lower figure is US$600 billion. While this figure may not be large, when compared with other indicators of good governance, it does affect economic performance as available evidence demonstrates. Countries with good institutions have grown faster within the past 10 years compared to those without good institutions. Thus, corruption is a serious economic issue that deserves serious attention.[71]

The fourth challenge is that higher incomes would boost better governance so it is not worth expending scare resources on advocating good governance and fighting corruption. But Kaufman et al. argue that it is *poverty that causes corruption*, so poverty alleviation should take priority. In their view, the challenge is misleading because there is evidence that good governance boosts income and causes higher economic growth, which will

[71] Id., at p83.

eventually eradicate poverty. The fifth challenge is that good governance and institutional reform would take generations to improve. Deeply rooted problems cannot be fixed over a short period of time. This means whether there has been any improvement or not cannot be accurately measured within a few years after causing institutional reforms to implement good governance policies. While that is true, Kaufman et al. counter, statistical methodology and some simple rules of thumb have been developed to measure the effects of good governance during the past eight years since the adoption of the good governance indicators in 1996. This rule of thumb measures whether a country has *significantly improved* or *significantly worsened*. This provides confidence in the good governance policies advocated and implemented by the World Bank.[72]

The sixth challenge is that the best way to fight corruption is to take the issue head on by promoting tougher laws and heavier sanctions, establishing anti-corruption commissions, strengthening ethics agencies, promoting codes of conducts, and so on. However, in Kaufman et al.'s view, this 'fight corruption by fighting corruption' strategy does not address the fundamental causes of corruption, but often creates further opportunities for bribery. Focus on fighting corruption head on also diverts government attention on other fundamental issues like systemic governance reforms.[73]

The seventh challenge is the assumption that the culprit in developing countries is the public sector that is solely responsible for not providing and facilitating the requisite

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[72] Id., at pp.86-87.
[73] Id., at p.88.

business environment. But for Kaufman et al, that is, at best a simplistic view. The problem is more complicated. In reality, powerful private interests often exert undue influence in shaping public policy, institution and state legislation. 'In extreme cases, so-called oligarchs capture state institutions.' Therefore, the public sector is not the sole shaper of the investment climate faced by domestic firms and foreign investors in a country. The private sector is not a private spectator in policy formulation. There is a myriad of interplay between private interests and public bodies in governance and policymaking. 'More specifically, money in politics is at the heart of the interplay between the corporate and the public sectors, in terms of policy and institutional outcomes, and within it, the role played by political finances in exerting undue influence.'[74] This thesis endorses this assessment.

The last challenge is, that, if elected governments cannot improve governance, there is little that international financial institutions and donor agencies could do. Given the litany of failures as a result of intervention of donor agencies in the domestic affairs of developing countries, there is no need to repeat the same mistakes. Kaufman et al. respond to that by invoking hope - it is not good to be pessimistic. Hope is raised by the experiences of several countries like the fastest growing economies of East Asia, the democratic reforms in the transitional economies of Russia and Eastern Europe, significant political progress in many parts of Africa, and diverging governance paths of Latin America, all of which indicate that good governance and transparency reforms are working and have been effective.[75]

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[74] Id., at p.89.
[75] Id., at p.89.

With many arguments such as these, the World Bank and the IMF appear to have effectively synthesized and brought together all the diverging resource curse theories and remedies under one umbrella - *market-friendly institutions and policies* – characterized by *transparency* and *good governance*. Consequently, research institutions, international think-tank bodies, non-governmental organizations, environmental groups, international donor agencies, and even global multinational corporations are singing the same chorus – *transparency* and *good governance*.

The critical question is: Does *transparency* and *good governance* cause economic growth and development? Can prevention of waste, corruption and rent-seeking cause growth and development? Neoliberals in general and the IMF and the World Bank in particular certainly believe that *transparency* and *good governance* prevent waste, corruption, and rent-seeking, as Kaufmann et al entail above. This thesis disagrees on the ground that corruption has plagued humanity since time immemorial, and no one can eradicate it although it may be reduced or constrained.[76] Second, whether corruption and rent-seeking impedes growth and development is debatable just as the issue on open trade because evidence shows that amidst allegations of rampant corruption, Asian countries like India and China have grown consistently for decades.[77] For example, an editorial in a leading newspaper in India said: 'Corruption in public life is one of the most daunting issues facing the country. Things have come to such a pass *all* politicians evoke public ridicule.'[78] According to Gurharpal Singh,

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[76] Syed Hussein Alatas, *Corruption and the Destiny of Asia* (1999) p.49.

[77] Generally, see Alatas, ibid. On Indian growth, see Deepak Lal, 'An Indian Economic Miracle?' (Winter 2008) 28 (1) *Cato Journal* pp.11-34.

[78] *The Tribune,* (Chandigarh, 25th November 2003).

> Public life in today's India is dominated with concerns about corruption and the inability of politicians to tackle it effectively. In the last few weeks, scandals have followed scandals: a Cabinet Minister was caught on video accepting a bribe; a legal paper scam involving several states, politicians of many different parties, the police and the criminal underworld has defrauded the treasury of an estimated billion dollars; and regional politician is alleged to have massed nearly $800 million worth of property abroad.[79]

Similarly, Asian economies like China, South Korea and Indonesia are plagued with corruption to different degrees. Corruption in China is described as endemic, and yet its economy has been growing at about 10 percent for almost three decades.[80] Corruption survey in Indonesia shows that the public, private, and civil society sectors are all engaged in some form of corruption, and in percentage terms, 'interactions with higher corruption are duty institution (67%), police (70%), and army (55%), court (53%) and political party (54%), and these [are] concentrated in the big cities, such as Jakarta, Surabaya, Bandung, Medan, and Batam.'[81] Yet the World Bank views that Indonesia has managed its natural resource revenue well by committing them to capital investments in agriculture and education as seen in Chapter Five. Corruption in South Korea is not as bad as in the Philippines or as clean as in Taiwan, but relative corruption exists anyway.[82]

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[79] Gurharpal Singh, 'Corruption, Transparency and Good Governance in India' (Paper delivered at the EU-India Conference at Brussels, 4 December 2003).

[80] Minxin Pei, 'Corruption Threatens China's Future' (Policy Brief 55, Carnegie Endowment for International Peace, October 2007).

[81] Saiful, *Good Governance for Fighting Corruption in Aceh*, available online at http://pkukmweb.ukm.my/~pkaukm/BUKU%201%20&%202/PDF_buku%201/B8_Saiful_Good%20Governance%20For%20Fighting%20Corruption%20In%20Aceh.pdf. <Accessed 27.01.09>.

[82] 'Chapter IV. A Comparative Case Study of Corruption in South Korea, Relative to Taiwan and the Philippines: Focusing on the Role of Land Reform and Industrial Policy', by an anonymous author based on an earlier version presented at the Annual Meeting of American Political Science Association, Washington D.C., September 1-4, 2005. Available online at http://www.ksghome.harvard.edu/~youjong/Ch%204%20**Corruption**%20in%20**Korea**.doc. <Accessed 27.01.09>.

All these countries have grown and they are models of economic growth in neoliberal development discourse compared to Latin America. Based on such evidence, this thesis rejects the orthodox view that transparency and good governance cause growth. The position of this thesis is that there is no firm and conclusive evidence demonstrating that transparency and good governance indeed cause economic growth. Hence, a case by case approach is necessary to determine whether corruption or other factors or a combination of factors inhibit growth and progress in a given developing country. The tendency to adopt a *one-size-fits-all* policy of the World Bank and IMF such as transparency and good governance tantamount to privatizing public policy, which is corruption per se, and this approach needs to be abandoned. Each developing country deserves to be assessed separately and individually.

IV. INVESTMENT POLICY AND POLITICAL REFORM

The final prescription to avoid the resource curse covers the general area of 'investment climate', ranging from government investment decisions to combating corruption to maintaining law and order. Diversification, macroeconomic polices and establishing resource funds form part of the broader government investment policy mix. The gist of these policies is really to encourage governments to invest resource revenues in alternative sources of income, which can continue to sustain the economy at the end of the resource boom. On this issue, we already saw how Indonesia invested its resource revenue to strengthen the productive base of the tradable sector, especially in agriculture,

while Mexico invested heavily in Pemex, its national oil company - in the oil sector where rent-seeking was rife.[83]

The human capital theorists (Chapter Three) strongly argue that a government must have strong investment policy in education. Education is a prerequisite because diversification into manufacturing requires the use of human capital. Gylfason's argument is more forceful on this point: '*More and better education is a prerequisite for rapid economic development around the world.*'[84] An econometric analysis done by Damania and Bulte support this argument by pointing out that resource boom is linked to low education through rent-seeking and corruption.[85] In their view, Botswana and the East Asian 'economic tigers' escaped the resource curse because these countries invested heavily in human resource. It is submitted that the argument for investment in human capital is a good policy that resource-rich peripheral countries like PNG should pursue.

Some argue that investment is best carried out by the private sector.[86] In other words, resource curse occurs as a result of government involvement in business investments. This is the reason behind the crusade for de-regulation, small government, and market-friendly policies. While this is ideal, experience demonstrates that governments can also invest well, as the cases of China, Korea, Singapore, Botswana and Norway demonstrate.

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83 Paul Stevens, in 'Resource Impact – Curse or Blessing?: A literature Survey' (London: Centre for Energy, Petroleum and Mineral Law and Policy, University of Dundee, March 2003) at p.22.

84 Thorvaldur Gylfason, 'Natural Resources, Education and Economic Development' (2001) 45 *European Economic Review* p.847, at p.851. Emphasis added.

85 Richard Damania and Erwin Bulte, 'Resources for Sale: Corruption, Democracy and the Natural Resource Curse' (Discussion Paper No.0320, Centre for International Economic Studies, University of Adelaide, July 2003).

86 D.L.Bevan, P. Collier and J.W. Gunning, 'Trade Shocks in Developing Countries: Consequences and Policy Responses' (1993) *European Economic Review* p.37.

Russia also provides another contrasting and interesting example. Kaletsky observes that Russia under Boris Yeltsin's ultra-liberalism and free-market capitalism enabled private interests and 'mafia-styled' groups to loot Russia's public assets causing hyperinflation[87] but under Vladimir Putin, economic management has been competent and turned the global energy boom to generally good use.[88] 'In fact, the Putin dictatorship has a serious chance of creating a successful capitalist economy in Russia in much the same way that the Deng Xiaoping dictatorship turned China into an economic superpower.'[89]

Regarding political reforms, two strands of arguments seem to emerge from the resource curse literature. One, that democracy must replace other forms of government because only through democracy can a resource-rich developing country escape the resource curse.[90] This argument is untenable because the Chinese experience, and that of Russia, as well as the dictatorial regimes of General Suharto in Indonesia, Augusto Pinochet's Chile, which the neoliberal's hold up as a success story, and Dr. Lee Kuan Yew's Singapore, put it beyond doubt that the type of political arrangement has no relevance to economic growth and industrialization.

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[87] On IMF-imposed privatization and looting of public assets, see Stiglitz, above n6, pp.37-38; See also Karla Hoff and Joseph E. Stiglitz, 'The Creation of the Rule of Law and the Legitimacy of Property Rights: The Political and Economic Consequences of a Corrupt Privatization' (NBER Working Paper 11772, November 2005), available online at http://www2.gsb.columbia.edu/faculty/jstiglitz/papers.cfm <Accessed 09.10.07>.

[88] Anatole Kaletsky, 'Russia Stable as Putin Takes a Good Step Forward', *The Weekend Australian* (Sydney) 6-7 October 2007 at p.37. The Organisation for Economic Co-operation and Development (OECD), *Economic Survey of the Russian Federation 2006: Fiscal policy: The Principal Tool for Macroeconomic Management*, online at http://www.oecd.org/eco/surveys/russia, (Accessed 28.09.07>, supports this observation.

[89] Kaletsky, above n88.

[90] See for example, Damania and Bulte, above n85.

The other strand of the argument promoting the role of the private sector is to deal with government corruption and rent-seeking because it is assumed that the private sector does not engage in these sorts of activities. To this argument, Stevens points out that the real problem arises when the ruling elite lack any social anchor and alignment with the public and the state has become a predatory state.[91] This is sadly the situation in PNG today. Corruption has seeped through the fabric of PNG's modern institutions to make law enforcement difficult. For example, in an address to journalists on the conduct of the 2007 national elections, Dr. John Nonggorr, a prominent national lawyer, said: 'We are not enforcing the bribery law because everyone is involved in it.'[92] So, identifying corruption and rent-seeking as problems for economic growth is true in the case of PNG, as in many other resource-rich developing countries. However, the intellectual challenge is not to simply identify corruption as a problem but to understand why it occurs and how to deal with it. According to the World Bank's diagnosis we saw above, one reason for corruption is poverty. This thesis begs to differ. In most cases, however, rich rulers and wealthy private persons are engaged in corrupt deals.[93] In the case of PNG, it is not poverty but a truncated understanding of cultural values like *reciprocity* that explains corruption. The RCT unfortunately rejects cultural factors as irrelevant, but in this thesis, it is one of the main causes of corruption.

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[91] Stevens, above n83, at p24.

[92] Harlyne Joku and Elisabeth Miae, 'Money Politics Rife: Nonggorr', in *The National* (Port Moresby) Friday 29 June 2007, accessed online at http://www.thenational.com.pg/062907/nation4.htm <Accessed 29.06.07>.

[93] The National Provident Fund (NPF) case in PNG, and other cases in PNG that I have personal knowledge of, as well as international cases examined in chapter 7 prove that the wealthy and powerful are involved in corruption involving millions rather than petty cases of the poor seeking means and ways to survive, which the World Bank mentions.

On the question of how to deal with corruption, Stevens suggests that civil society should be strengthened to align with the State from being predatory to developmental. Another constraint should come from international financial institutions as part of their conditions for financing and debt management arrangements.[94] Similarly, Stiglitz argues that developed countries need to provide role models, give advice and provide assistance in ways that change incentives and opportunities, and do whatever they can to circumscribe the enormous forces of corruption that come from the developed world through their multinational corporations.[95] While international actors can assist only to a certain point, Stiglitz continues, the major responsibility should rest with the developing countries themselves.[96]

As we will see in the next chapter, concerted efforts by international civil societies, governments, the Bretton Woods institutions, and transnational corporations to fight corruption and rent-seeking seem to suggest that opinions such as that of Stevens and Stiglitz have been well taken.

V. CONCLUSION

In the view of this thesis, the Third World has become the laboratory for testing untested development theories concocted in First World research institutions. When modernisation theory failed, neoliberal theory took over. When neoliberalism fails, First World theorists will come up with something else. When modernisation theory championed the cause of democracy and capitalism over communism under the pretext of

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94 Stevens, above n83, at p.24.
95 Stiglitz, above n6., pp.150-151.
96 Id., at p.150.

modernising Third World countries, neoliberalism is championing the cause of free market capitalism in the name of economic growth that will solve poverty theorised to be caused by the curse of resource abundance. The Third World remains the subject and the victim of First World theories and ideological conflicts. Therefore, underdevelopment economics is correct to assert that Third World underdevelopment is a reflection of First World development, be that intellectual or material development.

By advocating open trade, the RCT fails to consider trade restrictions against Third World exports to the First World. The RCT only demands Third World countries to open their borders to unrestricted flow of goods from the First World. The assumption is that this unbalanced trade in favour of the First World would solve the resource curse. To say the least, this is too simplistic. What is difficult to understand though is that despite overwhelming evidence negating this assumption, international development establishments are promoting open trade as a genuine policy savior to the underdeveloped world. This thesis regards such an arrogant position as nothing more than 'intellectual imperialism', to say the least.

Similarly, this thesis submits that demanding good institutions such as secure private property rights, strong law and order, transparency and good governance are not for the benefit of developing countries but for the protection of foreign investors. Foreign investors know that strong institutions would silence the exploited majority and keep them from revolting. Good institutions would protect their investments, and allow them to siphon off the peripheral wealth to the centre. Good institutions would legitimize

'theft' of indigenous property rights and perpetuate exploitation. When the exploited legitimately resist, political, economic and military means are applied to suppress them. To justify the suppression and garner public support, coded words such as *freedom*, *democracy*, *good governance*, and *transparency* – catchy phrases that promise prosperity and freedom from poverty – are employed. After many years of plundering peripheral wealth under such catchy phrases, and seeking to redeem his condemned conscience, John Perkins confesses: '*The corporatocracy makes a show of promoting democracy and transparency among the nations of the world, yet its corporations are imperialistic dictatorships where a very few make all the decisions and reap most of the profits*.'[97] Perkins then goes on to argue that contrary to the liberal democratic ideals of the U.S. enshrined in its Constitution, the military-industrial complex, which he calls *corporatocracy*, 'is built on foundations of greed, secrecy and excessive materialism.'[98]

Allan Greenspan, former chairman of the U.S. Federal Reserve Banking System, admitted publicly that greed, secrecy and excessive materialism that comes from oil was the reason for going to war with Iraq. 'I am saddened that it is politically inconvenient to acknowledge what everyone knows: the Iraq war is largely about oil.'[99] Although many experts like Perkins and Greenspan know that the resource curse is a misnomer for the consequence of corporate greed and excessive materialism it is politically inconvenient

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[97] John Perkins, *The Secret History of the American Empire: Economic Hitman, Jackals, and the Truth About Global Corruption* (2007) at p.7. Emphasis added.

[98] Ibid.

[99] Graham Paterson, 'Allan Greenspan claims Iraq war was really for oil', *TimesOnline* at http://www.timesonline.co.uk/tol/news/world/article2461214.ece. <Accessed 26.10.07>

for the resource curse theorists to state the obvious. Why? Because 'speaking the truth is a career-ending [or career-threatening] event.'[100]

Therefore, if '[d]evelopment is about transforming lives of people, not just transforming economies,'[101] then failing to expose the truth in order to protect one's career would not resolve the resource curse. The solutions offered so far by the resource curse discourse, in my view, are policies that would transform First World economies and not Third World human lives. Indeed, promoting growth without promoting equity is promoting greed, secrecy and excessive materialism, and not lifting people out of poverty.

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[100] Paul Craig Roberts, 'In America, Speaking the Truth is a Career-ending Event' (*Information Clearing House*, 26 January 2009). Available at http://www.informationclearinghouse.info/article21847.htm. <Accessed 27.01.09>.

[101] Stiglitz, above n6, at p.50.

CHAPTER SEVEN

GLOBAL ACTIONS TO ADDRESS THE RESOURCE CURSE

INTRODUCTION

International development agencies and financial institutions like the International Monetary Fund (IMF) and the World Bank, governments of the Organization for Economic Co-operation and Development (OECD) countries, and civil society groups have recently set up programs and taken a number of practical steps to address the resource curse. So far, all these practical steps and programs are based on the assumption that the primary cause of the resource curse emerges from explanations offered by the corruption and rent-seeking theories. Accordingly, all the international efforts centre on *transparency* and *good governance* programs and actions to prevent corruption and rent-seeking. The assumption is that minimization or elimination of corruption and rent-seeking will ultimately lead to economic growth and usher in prosperity.

The purpose of this chapter is to examine some of these international efforts to enforce *transparency* and *good governance* principles in resource-rich developing countries by the three international actors – governments of industrialised countries, international financial and development institutions, and civil society groups. Are these groups 'good Samaritans' genuinely concerned with the plight of resource-rich but poor developing countries, or are they self-interested capitalists promoting neoliberal reforms for capitalist exploitation? The answer to this question will become apparent by the end of this chapter.

The chapter is arranged into six sections. Section I examines the programs and actions of the World Bank and the IMF to promote *transparency* and *good governance* in order to combat corruption. Section II looks at *transparency* and *good governance* programs and policies of the OECD countries. Section III examines a selection of civil society groups among many others who are advocating *transparency* and *good governance* to combat corruption. Section IV analyses the combined efforts of all these three groups under what is called *Extractive Industries Transparency Initiative* (EITI). Section V provides some analytical comments. The final section is a conclusion.

I. COMBATING CORRUPTION THROUGH TRANSPARENCY AND GOOD GOVERNANCE PROGRAMS BY THE WORLD BANK AND THE IMF

As we saw in Chapter Six, corruption has been for many years a topic of limited interest among economists and policy makers[1] because the topic focused on the narrow meaning of 'the exploitation of public office for personal gain'[2] until recently when neoliberal economists largely informed by *public choice theory*[3] expanded the definition to mean '*the privatization of public policy*' which captures *undue influence* by private interest groups exerted on public officials.[4] In advocating *transparency* and *good governance* to combat corruption, the World Bank and the IMF however do not see themselves as

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1 Mitchell A. Seligson, 'The Impact of Corruption in Regime Legitimacy: A Comparative Study of Four Latin American Countries' (2002) 64 (2) *The Journal of Politics* p.408.

2 Peter Grabosky and Peter Larmour, 'Public Sector Corruption and Its Control' (2000) 143 *Trends & Issues in Crime and Criminal Justice,* available online at http://www.aic.gov.au. <Accessed 13.09.05>.

3 James M. Buchanan and Gordon Tullock developed and popularized this theory in their *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (1962); Vincent Ostrom, 'Public Choice Theory: A New Approach to Institutional Economics' (1975) 57 (5) *American Journal of Agricultural Economics* pp.844-850; Vincent Ostrom and Elinor Ostrom, 'Public Choice: A Different Approach to the Study of Public Administration' (1971) 31 (1) *Public Administration Review* pp.203-216; Gary S. Becker, *The Economic Approach to Human Behavior* (1976).

4 Daniel Kaufmann, Aart Kraay and Massimo Mastruzzi, 'Governance Matters VI: Aggregate and Individual Governance Indicators 1996-2006' (World Bank Policy Research Paper 4280, Washington D.C., July 2007) pp.3-4.

exerting *undue influence* by *privatizing public policy* by demanding developing countries to adopt the Washington Consensus. To avoid falling into this trap, these two institutions and other transparency and good governance campaigners accept the earlier narrow definition of corruption that can take many forms:

- **Bribery**: where an official accepts money or some other consideration to engage in a particular course of action, or inaction.
- **Extortion**: where an official demands money or some other consideration to engage in a particular course of action, or inaction.
- **Embezzlement**: where an official misappropriates public assets for personal use.
- **Fraud**: where an official makes a false claim for benefits for which he or she is not entitled, or in order to avoid liability for payment, such as tax or customs duty.
- **Conflict of interest**: where an official stands to profit incidentally from an official act. This could involve a planning decision which has the effect of increasing the value of property owned by the official, or awarding of a government contract to a company in which the official has a financial interest.[5]

At the World Bank Group (WBG), corruption was seen as a political issue 'until President James Wolfensohn [1995-2005]…began emphasizing its adverse effects on development, a view substantiated by World Bank and other studies.'[6] Since then the Bank took head on the issue of corruption by urging countries to adopt principles of *transparency* and *good governance*. In the new millennium, concerned about the resource curse, and particularly in response to criticisms and pressure from environmental and human rights groups that the WBG was involved in natural resource projects without due regard to poverty, human rights violations, and lack of economic and social progress

5 Grabosky and Larmour, above n2; Syed Hussein Alatas, *Corruption and the Destiny of Asia* (1999) pp.6-7. Emphasis added.

6 Joseph E. Stiglitz, 'The Overselling of Globalization,' in Michael M. Weinstein (ed), *Globalization: What's New* (2005) pp.228-261.

despite resource abundance, the Bank announced in June 2000 that it would conduct a comprehensive review of its involvement in the extractive industries.[7] Through its independent Operations Evaluation Department (OED), the Bank reviewed its assistance to extractive industries in many resource-rich developing countries between July 2001 and December 2003. The objective of the Review was to determine whether the Bank's involvement in extractive industries is compatible with its global mission to promote sustainable development and combat poverty. Dr. Emil Salim, former Indonesian Minister for Population and Environment, headed the Review. The Extractive Industries Review (EIR) consulted numerous stakeholders, held conferences and workshops at various regional offices and provided an open forum for civil society testimony.[8] After three years of travel, research, consultations and work, the Review submitted its findings to the WBG in January 2004.

The specific issue the EIR was assigned to determine was: 'Can extractive industries projects be compatible with the WBG's goals of sustainable development and poverty reduction?' The EIR answer was affirmative provided the following three important conditions are present:

- pro-poor public and corporate governance, including proactive planning and management to maximize poverty alleviation through sustainable development;

7 Information on the history and activities of the Extractive Industries Review can be accessed through http://www.ifc.org/eir, or on the home page of the World Bank at http://www.worldbank.org/. <Accessed 18.10.07>.

8 Dr. Samil and his team visited PNG from 2-11 August 2002. The team visited Lihir on 6, Kutubu on 8, and Misima on 9 August 2002. They visited Chad and Cameroon between 10-21 October 2002, Mozambique between 13-17 January 2003, just to mention a few. Submissions were received from as diverse groups as the International Council on Mining (ICMM) to Lawyers' Environmental Action Team, Tanzania.

- much more effective social and environmental policies; and
- respect for human rights.[9]

The particular factors required for good governance in extractive industries include the need to:

- promote transparency in revenue flows;
- promote disclosure of project documents;
- develop the capacity to manage fluctuating revenues;
- develop the capacity to manage revenues responsibly;
- help governments develop modern policy and regulation frameworks; and
- integrate the public in decision-making processes at local and national levels.[10]

The WBG *Management Response* was released in September 2004. The response is generally favourable. It received the recommendations and identified actions that the WBG would undertake to implement the recommendations, particularly with respect to good governance.

After observing the WBG's performance on their commitment to implement the EIR recommendations since then, some civil society groups have accused the Group of ignoring the EIR recommendations. For instance, in a highly critical report released in

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[9] Extractive Industries Review (EIR), *Executive Summary*, at p.1, online at http://www.worldbank.org/. <Accessed 18.10.07>.

[10] Id., at p.2.

January 2006, Shannon Lawrence of Environmental Defense,[11] and Nikki Reisch of Bank Information Centre[12] claim that '*the Bank Group has largely ignored the finding of the EIR final report and its own Operations Evaluation Department…*'.[13] They argue that the Bank has selectively focused on *revenue transparency* and *economic management*, and ignore other elements of transparency such as risk of conflict, human rights protection, and capacity to mitigate and manage the impacts of extractive industries development.[14] The WBG has also failed to engage in participatory process to develop or select extractive industries-specific indicators to address the transparency and governance issues. Although the WBG uses the *Country Policy and Institutional Assessment* (CIPA) instrument, this tool was formulated without the input of the public. Moreover, the CIPA primarily concentrates on *fiscal* or *economic policies* and the regulatory environment. While the World Bank Institute *Governance Indicators* present a more comprehensive view of the core elements of good governance, which include political and civil rights, prescriptive power over decisions about WBG support for projects and country strategies are absent.[15] Some media commentators have supported these critical views. For instance, *The Observer* newspaper published on Sunday, 30 September 2007, reported that Britain urged the World Bank 'to investigate allegations of

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11 Environmental Defense's online home page is at http://www.environmentaldefense.org/home.cfm. <Accessed 17.10.07>.

12 The objectives of the Bank Information Centre can be viewed at home web page at http://www.bicusa.org/en/Index.aspx. <Accessed 17.10.07>.

13 Shannon Lawrence and Nikki Reisch, *The World Bank Group, The Extractive Industries Review (EIR) and Governance: Evaluating the Bank Group's Implementation of Its Commitments* (January 2006), online at http://www.environmentaldefense.org/documents/5057_ED_BIC%20WBEIR%20governance%20(Jan06).pdf. <Accessed 17.10.07>. Italics is original.

14 Ibid.

15 Ibid.

corruption and embezzlement in a $35m (£17m) water project in Armenia,' but the Bank refused on the ground that the fraud was not serious but only of 'medium priority'.[16]

Like the World Bank, the IMF believes that since its core mission of macroeconomic stabilisation requires good governance, *fiscal transparency* is thus a key ingredient in good governance.[17] In pursuance of this belief, the IMF introduced in 1998 a *Code of Good Practices on Fiscal Transparency* (the Code), which led to a voluntary program of fiscal transparency assessments called *Fiscal Transparency Modules of Reports on the Observance of Standards and Codes* (OSCs). The Code policies plus guidelines on the fiscal OSCs are expanded and explained in the *Manual on Fiscal Transparency* released in April 2007 (Manual). To address the unique set of problems faced by developing countries dependent on natural resource revenues, the Fund also issued a *Guide on Resource Revenue Transparency* (Guide) in 2005. The Guide has been updated together with the Manual in 2007.[18] The fiscal transparency manual has four pillars of transparency. These are:

- clarity and roles of governments;
- open budget processes;
- public availability and access to information; and
- assurances of integrity.

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[16] *The Observer*, online at http://observer.guardian.co.uk/business/story/0,,2179920,00.html. <Accessed 17.10.07>.

[17] IMF 2007 Annual Report, p.54, available online at http://www.imf.org/external/pubs/ft/ar/2007/eng/pdf/file6.pdf. Accessed 22.10.07>.

[18] These documents can be accessed through its home page at http://www.imf.org/. <Accessed 22.10.07>.

Under the first pillar, it calls for clear government structure and functions where the fiscal powers of the legislature, executive and judiciary are well defined; provide clear and the specifics of intergovernmental relationships; government and public corporations relationship to be based on clear arrangements; and government-private sector relationship to be open and follow clear rules and procedures. Under the second pillar, the IMF calls for comprehensive budget, tax and other public finance laws to govern the collection and commitment and use of public funds; government-resource industry contracts to be clear and accessible to the public; and for government to have legal authority to licence the extraction of natural resources, among others. The third pillar is merely concerned with publication and dissemination of budget documents, whilst the fourth pillar describes the details of what is required for responsible fiscal management including budget and expenditure trend to reflect well-defined policy commitments.

The specific transparency principles to guide the management and distribution of natural resource revenue under the *first pillar* entail seven roles and responsibilities. *First*, a government is required to ensure it has clear legal title to natural resources, with a strong and clear natural resource legal regime to regulate the exploration, extraction and export of the resources. *Second*, a clear and comprehensive natural resource policy and law on taxation or production sharing arrangement should be made available for public view and comments. *Third*, there must be law specifying fiscal authority over resource-related revenue, and borrowing. Law should require full disclosure of all resource-related revenue, loan receipts, liabilities, and asset holdings. *Fourth*, government equity participation and its implications should be fully disclosed to the public. *Fifth*, the roles

of national oil and mineral companies, and that of the resource-sector ministries and the finance ministry should be clearly defined. *Sixth,* expenditures incurred by both national and international companies in social and environmental areas, or subsidies to producers and consumers without explicit budget support should be clearly defined and described in budget documentation. *Finally*, funding arrangements between national and provincial or local-level governments should explicitly reflect national fiscal policy and macroeconomic objectives.

Under the *second pillar* – open budget processes – four transparency principles are prescribed. *First*, there should be a budget framework, which incorporates a clear policy on the rate of exploitation of natural resources and the management of resource revenues with reference to the overall fiscal and economic objectives, including long-term fiscal sustainability. *Second*, where a resource fund has been established, mechanisms for operation and coordination of the fund with other fiscal activities should be established. *Third*, operational rules related to resource-related funds should be stated as an overall fiscal policy framework. And, *finally*, investment policies for assets accumulated through resource revenue savings should be clearly stated in annual budget documents. The IMF was instrumental in the establishment of oil funds in Timor-Leste, Russia, Azerbaijan, and Kazakhstan we saw in Chapter Five, and other resource-rich nations in Africa on the premises of this *open budget process* transparency doctrine.

The *third pillar* has eight specific principles including budget documentation of resource revenues and spending, reporting on company revenue payments, fiscal balance,

reporting on resource-related debt, reporting on assets, estimating resource asset worth, reporting contingent liabilities and quasi-fiscal activities and fiscal risks. The *fourth* (and last) *pillar* specifies four principles including internal control and audit of resource revenues, tax administration openness, oversight of companies, and oversight of company-government revenue flows.

Some commentators have argued that the *transparency* and *good governance* conditionalities imposed on borrower countries by the Fund and the WBG amount to interference in domestic politics without mandate.[19] This is to say that elected politicians have little choice over the development trajectories of their countries. Moreover, since the World Bank's new definition of corruption is *privatization of public policy*, which means interfering in domestic politics without mandate, the Bank and the Fund are, by their own definition, engaging in corruption.

II. OECD BUDGET TRANSPARENCY MODEL

Countries of the OECD have also been advocating budget transparency. In its May 2001 *Best Practices for Budget Transparency*, the OECD adopts three principles on budget transparency.[20] These are (1) budget reports, (2) specific disclosures, and (3) integrity, control and accountability.

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[19] Devesh Kapur and Moises Naim, 'The IMF and the Democratic Governance' (Jan. 2005) 16 (1) *Journal of Democracy* pp.89-102.

[20] OECD, *OECD Best Practices for Budget Transparency*, available online at http://www.oecd.org/dataoecd/33/13/1905258.pdf. <Accessed 22.10.07>.

First, budget reports must include *pre-budget* report, *monthly* reports, *mid-year* report, *year-end* report, *pre-election* report and *long-term* report. *Pre-budget* report serves to encourage debate. As such, it must be released at least one month before the budget session. The *monthly* report is designed to show progress in implementing the budget. These reports should be released at the end of each month. The *mid-year* report should provide a comprehensive update on the implementation of the budget, including an updated forecast of the budget outcome for the current fiscal year. The report should be released within six weeks of the end of the mid-year period. The *year-end* report is the key government accountability document. It should be audited and released within six months of the end of the fiscal year. The *pre-election* report serves to illuminate the general state of government funds immediately before an election, and serves to stimulate public debate. The *long-term* report assesses the long-term sustainability of current government policies. It should be released at least every five years.

A government's key fiscal risk arises from deviation from economic assumptions underlying the budget. All key economic assumptions like GDP growth, the composition of GDP growth, the rate of employment and unemployment, the current account, inflation and interest rates must all be disclosed. The estimated cost of tax expenditures should be disclosed, as well as all financial liabilities and financial assets, especially in the mid-year and year-end reports. All non-financial assets should also be disclosed. Employee pension obligations, contingent liabilities like legal claim against the government, which would impact upon the budget, should be disclosed as well.

In other words, the government should adopt best accounting practices like those used in the private sector. The relevant accounting principles, policies and method adopted in preparing the reports should be included. Dynamic internal financial controls, internal audits, and so on should be put in place to assure the integrity of information provided. The year-end report should be audited in accordance with generally accepted auditing practices. Parliament should have the resources to effectively examine any fiscal report that it deems necessary. And finally, all fiscal reports should be made available to the general public. The finance ministry should ensure that the public understands the budget documents and fiscal policies.

Recently, the OECD countries have directed their aid policies towards the promotion of good governance and transparency in line with their policies outlined above.[21] For instance, the recent *Enhanced Cooperation Agreement* (ECA) program between Australia and Papua New Guinea which would cost Australia anywhere from AU$800 million to $1.1 billion to implement within five years commencing August 2004 require good governance and transparency.[22] The purpose of the ECA is 'to address core issues in PNG in the areas of governance, law and order and justice, financial management,

[21] See the *Paris Declaration on Effective Aid*, endorsed in 2005, *Principles for Donor Action in Anti-Corruption*, and Recommendation on *Anti-Corruption Proposals for Aid-Funded Procurement,* all available online at http://www.oecd.org/dataoecd/33/13/1905258.pdf. <Accessed 22.10.07>.

[22] Alexander Downer, Australian Foreign Affairs Minister, 'Treaty Marks New Era of Co-operation with PNG' (Media Release, 30 June 2004). The Agreement came into force in PNG on 9 August and in Australia on 13 August 2004. A critique on the Agreement is provided in MJ Kuwimb, 'Joint Agreement on Enhanced Co-operation Between Australia and Papua New Guinea Enhancing the Security of Australia' (an unpublished article dated 12 December 2004).

economic and social progress as well as capacity in public administration, including the Royal Papua New Guinea Constabulary.'[23]

III. CIVIL SOCIETIES AND TRANSPARENCY CAMPAIGNS

There are many civil society groups or non-government organizations (NGOs) campaigning for transparency and good governance in their fight against global poverty. In this section, we will look at only four organizations or programs among many other similar groups and programs. These are the *Open Budget Initiative* (OBI), *Publish What You Pay* (PWYP), the *Open Society Justice Initiative* (OSJI), and *Initiative for Policy Dialogue* (IPD).

It is useful to clarify here that many of these NGOs or initiatives and programs are headed and funded by *non-resource curse theorists*. This is to say that *resource curse theorists* are those who theorize resource abundance and internal political factors as being responsible for causing poverty, lack of economic growth, and lack of or slow industrialisation in resource-rich developing countries. The non-resource curse theorists, on the other hand, are those who campaign for poverty reduction and address the regressive social and economic conditions in developing countries based on their charitable objectives, which their organisations pursue. In the new millennium, neoliberal resource curse remedies of transparency and good governance have merged with the transparency and good governance campaigns of NGOs, thereby obfuscating the ideological and motivational division between the two.

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[23] Article 2, *Joint Agreement on Enhanced Cooperation Between Australia and Papua New Guinea 2004* (ECA).

A. Open Budget Initiative and Follow the Money

The IMF's call for open budget process and revenue management transparency converges with civil society organisations that have been calling for transparency in the use and management of natural resource revenues. In particular, the *International Budget Project* (IBP), founded in 1997 and based at Washington D.C. with civil society engagements in over 60 countries, has, since its inception, been engaged in promoting the growth of civil society organisations to analyse, monitor, and influence government budget processes, institutions and outcome with the objective to make budget systems more responsive to the needs of poor and low-income people in society, and to make the budgetary systems more transparent and accountable to the public.[24] The IBP pursues its objectives through five major programs. These are:

- providing training and technical assistance;
- measuring and advancing transparency and participation in the budget process;
- expanding the donor finance available for civil society budget work;
- acting as a hub of information on civil society budget work; and
- building international and regional budget networks.[25]

The IBP's engagement with NGOs in many developing countries has produced some positive results. The following are indicative:

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[24] See these objectives on its web page at http://www.internationalbudget.org/. <Accessed 22.10.07>.

[25] IBP, *Open Budget Initiative 2006*, available online at http://www.internationalbudget.org/. <Accessed 22.10.07>.

- IBP campaign together with other civil societies in Mexico led to substantial increases in federal funding to eliminate rural maternal mortality.
- In South Africa, IBP work effectively pressured the government to enhance its budgetary allocation toward child support for poor and low-income families.
- In India and Uganda, IBP monitoring of district level or local level budgets has led to substantial reductions in corruption associated with public service provision.
- In Argentina and Kenya, IBP engagement in budget has improved the effective management of the legislature and Supreme Audit Institution in budget oversight.[26]

Buoyed by these positive results, the IBP met with many other civil society groups at the Central European University in Budapest, Hungary, in April 2004 to discuss what it takes to succeed in monitoring how governments manage public money. The experiences of civil societies shared at that meeting has been published in 2005 by the Open Society Institute as *Follow the Money: A Guide to Monitoring Budgets and Oil and Gas Revenues*.[27] The opening sentence in the Foreword in *Follow the Money* reads: 'Many countries rich in natural resources squander their wealth, enriching a minority, while corruption and mismanagement leave the majority impoverished. Breaking that pattern is

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26 See 'What is the IBP?' section on the IBP home page http://www.openbudgetindex.org/. <Accessed 22.10.07>.

27 Jim Shultz, *Follow the Money: A Guide to Monitoring Budgets and Oil and Gas Revenues* (2005).

difficult.'[28] The book goes on to note that enforcing measures against corruption and mismanagement and breaking the pattern is difficult because:

- leading democracies of the world, especially the OECD countries, are constrained from insisting on fiscal transparency and good budget practices because they are heavily dependent on oil, gas and mineral imports; and
- transnational corporations engaged in the extractive industries cannot because they too are dependent on good relations with the host government.

Therefore, the responsibility falls on civil society in resource-rich developing countries.[29] But civil societies in these countries are rendered less effective by four factors: (1) analysing information and disseminating to the wider public, (2) building and maintaining advocacy coalition, (3) effective media work, and (4) dealing with public officials. *Follow the Money* provides details on these four key factors and on how successful budget and revenue work.

As part of its tool for training, supporting and equipping civil societies to follow the money and demand transparent budgets, the IBP developed and released *Open Budget Index* 2006 (OBI).[30] The OBI is a culmination of IBP survey instruments first developed in 2002. The survey, which consists of 122 multiple-choice questions, is the first of its

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[28] Svetlana Tsalik, (Director, Revenue Watch of Open Society Institute), and Anthony Richter, (Associate Director of Open Society Institute), who contributed the Foreword in the book *Follow the Money*, id., at p.7.

[29] Tsalik and Richter, ibid.

[30] This OBI is available online and accessible at http://www.openbudgetindex.org/. <Accessed 22.10.07>.

kind for an independent, non-government view of central government budget transparency. Based on surveys conducted by civil societies and academic partners of IBP in 59 countries, the OBI determines whether a country provides:

- extensive information to citizens,
- significant information to citizens,
- some information to citizens,
- minimal information to citizens, and
- scant or no information to citizens.

Using integers between 0 and 100 in percentages, countries that scored 81-100 percent in response to 91 questions on IBP's *Open Budget Questionnaire* are identified as falling under the first category – they provide extensive information.[31] Countries that scored between 61-80 percent fall under the second category – provide significant information. Countries that scored between 41-60 percent provide some information – third category; those that scored 21-40 percent provide minimal information, and those with 0-20 score provide scant or no information.[32]

Among the countries that were studied, Papua New Guinea scored 51 percent on the OBI 2006 together with Namibia, Pakistan and the Philippines. The highest score was France with 89 percent, whilst the lowest was Vietnam with 2 percent.

[31] The *Open Budget Questionnaire* is also accessible online at http://www.openbudgetindex.org/. <Accessed 22.10.07>.

[32] Warren Krafchik, *Open Budget Initiative 2006: More Public Information Needed to Hold Governments to Account* (2006).

B. Publish What You Pay (PWYP)

The *Publish What You Pay* campaign is perhaps one of the most concerted and effective campaigns by global coalition of civil society groups for transparency and good governance in fighting against the resource curse. *Publish What You Pay* (PWYP) was launched in 2002 by George Soros, Chairman of the Open Society Institute of New York. The founding NGOs at this launching comprised (1) Global Witness, (2) CAFOD, (3) Open Society Institute, (4) Oxfam GB, (5) Save the Children UK, (6) and Transparency International UK. Since then, this small founding coalition of NGOs have been joined by others such as Catholic Relief Services, Human Rights Watch, Partnership Africa Canada, Pax Christi Netherlands and CARITAS – France. By 2008, the number has swelled to well over 300 coalition partners.

The original vision of PWYP was conceived in December 1999 in a Global Witness report entitled *A Crude Awakening: The Role of Oil and Banking Industries in Angola's Civil War and the Plunder of State Assets*.[33] That report exposes the apparent complicity of big oil and banking industries from the industrialised countries in plundering state assets during Angola's 40-year civil war. The report points out that the refusal to release financial information by major multinational oil companies aided and abetted the mismanagement and embezzlement of oil revenues by the ruling elite in Angola. The report concludes with a public call on the oil companies operating in Angola to 'publish what you pay'.

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[33] That report can be downloaded from Global Witness's home page at http://www.globalwitness.org/. <Accessed 18.10.07>.

According to Global Witness, the call for companies to *publish what you pay* and for governments to *publish what you earn* is a necessary first step towards a more accountable system for the management of natural resource revenues.[34] If companies disclose what they pay, and governments disclose their receipts, then members of civil society in resource-rich countries will be able to compare the two and thus hold their governments accountable for the management of this valuable source of income. Revenue transparency will also help civil society groups to work towards a democratic debate over the effective use and allocation of resource revenues and public finance in order to meet development objectives, improve public services, and redistribute income.

While conceding that mining, gas and oil companies cannot control how governments spend taxes, royalties and fees, Global Witness argues that transnational corporations have a responsibility to disclose the payments they make so that citizens can hold their governments accountable. In their view, companies that fail to disclose their payments to host governments are complicit in the disempowerment of the people of the countries to which the resources belong. 'Transparency will strengthen companies' social "licence to operate", by demonstrating their economic contribution to society, and increase the likelihood that the revenues they pay to governments will be used for sustainable development – which creates a stable business environment – rather than being wasted or diverted by corruption, which exacerbates social divisions and can lead to weak and unstable states and conflict.'[35]

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34 Global Witness, online at http://www.globalwitness.org/. <Accessed 18.10.07>.

35 Ibid.

C. Initiative for Policy Dialogue

Joseph Stiglitz, who was senior vice president and chief economist of the World Bank from 1997 to January 2000 during the Clinton administration, firmly believes that transparency is one of the strongest tools against corruption.[36] As he puts it: 'Transparency has long been recognized as one of the strongest antidotes to corruption; as the expression has it, "Sunshine is the strongest antiseptic." If citizens are to provide a check against corruption, they have to know what is going on.'[37] In several publications, Stiglitz has relentlessly argued this point.[38] In a lecture at Oxford University in 1999, Stiglitz confessed: 'My interest in openness has been long-standing. … As an economist of the public sector, I have argued for the virtues of transparency and openness.'[39] Recalling history, Stiglitz points out that the large and secret expenditure on the Vietnam War effort led to inflation in the United States. That inflation was further exacerbated by the oil price hikes in the 1970s. This situation ultimately culminated in the United States abandoning the gold standard. That abandonment ushered in a floating and volatile international financial regime, which requires surplus budgets and healthy foreign reserves to prevent volatility-induced inflation.[40] This economic domino effect was set off by secret use of public funds, which, had the public known, would have demanded accountability and justification, and by so doing perhaps prevent the adverse economic chain reaction that ensued.

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36 Stiglitz was Chairman of the Council of Economic Advisers (CEA) during the Clinton presidency.

37 Stiglitz, (2006) above, n40 at p.151.

38 These publications can be accessed online at http://www2.gsb.columbia.edu/faculty/jstiglitz/papers.cfm.

39 Joseph E. Stiglitz, 'On Liberty, the Right to Know and Public Discourse: The Role of Transparency in Public Life' in Ha-Joon Chang (ed), The Rebel Within (2001) pp.250-278. Also published in Matthew Gibney (ed), *Globalizing Rights* (2003) pp. 115-156.

40 Alice H. Amsden, in *Escape from Empire: The Developing World's Journey Through Heaven and Hell* (2007), provides lucid description of how this occurred.

For this and other similar reasons, Stiglitz argues that public access to information is as critical today as it was at the time of James Madison, the architect of the First Amendment of the US Constitution guaranteeing freedom of speech. Madison had argued: "*A people who mean to be their own governors must arm themselves with the power that knowledge gives. A popular government without popular information or the means of acquiring it is but a prologue to a farce or a tragedy or perhaps both*."[41] For Stiglitz, from Jeremy Bentham to John Stuart Mill and right down to the present, the golden thread of liberal and participatory democracy has always been meaningful participation by an informed citizenry.[42] Secrecy severs this golden threat by hobbling their ability to participate meaningfully. Just as the power of a corporate board and shareholders to make investment decision is constrained or expanded by the information provided to them by management, so are the people in choosing their leaders and holding them accountable.[43]

Citizens have to know how much they are receiving from natural resources and how that money is being distributed by their government. Citizens must be in a position to hold leaders accountable because state law enforcement agencies fail to enforce the law either because they too are implicated in corrupt deals, as is often the case in PNG,[44] or because corrupt money used in bribery is tax deductible and thus presumed to be legitimate (when, in fact, it is not), as is the case in some developed countries like Switzerland,

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[41] Letter from James Madison to W. T. Barry, 4 August 1822, in Saul Padover (ed), *The Complete Madison* (1953), quoted in Ted G. Carpenter, *The Captive Press: Foreign Policy Crisis and the First Amendment*, (1995), quoted in Stiglitz, above n39, at p.5. Emphasis added.

[42] Stiglitz, id., at p.6.

[43] Id., at p.7.

[44] See for example, Harlyne Joku and Elisabeth Miea, 'Money Politics Rife: Nonggorr' *The National*, (Port Moresby) Friday 29 June 2007.

Luxembourg, Austria, Belgium, Japan and the Netherlands.[45] It is then left to civil society to apply political pressure to deal with corruption once they become aware of it.

Stiglitz points out that corruption involves both multinational corporations from developed countries offering bribes to relevant government ministers and senior public servants for oil and mineral rights, and leaders of resource-rich developing countries who willingly accepting these bribes.[46] Therefore, the responsibility to fight corruption falls squarely on the developed countries as well as the IMF and the World Bank on the one hand, and, on the other hand, the developing countries. Stiglitz offers three suggestions. First, developed countries plus the IMF and the World Bank should put pressure on oil and mineral companies to publish what they pay to their host governments of developing countries. Second, both developed and developing countries must enforce stringent anti-corruption laws. Third, there should be restrictions on secret bank accounts that hold bribery payments just as restrictions against bank accounts of terrorist groups have been put in place and vigorously enforced. Finally, the IMF should encourage developing countries to establish stabilisation funds.[47]

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45 See Joseph E. Stiglitz, *Making Globalization Work: The Next Steps to Global Justice* (2006) p.139.

46 Stiglitz is brave because, unlike most economists who dwell on the misdeeds of developing countries, he has relentlessly challenged the IMF and the World Bank, as well as developed nations to be open, transparent and more democratic, even to the point of being described by Kenneth Rogoff, Economic Counsellor and Director of Research of the IMF, as 'you are a towering genius academically but as a policy maker you are a bit less impressive'. Jamie Kern, 'Uncovered: Joseph Stiglitz' *The Bottom Line*, 18 September 2003; and that he is out of touch with reality and living in the Gamma Quadrant: see *BusinessWeek* dated 3 July 2006.

47 Joseph E. Stiglitz, 'Making Natural Resources Into a Blessing Rather Than a Curse' in Svetlana Tsalik and Anya Schiffrin (eds), *Covering Oil: A Reporter's Guide to Energy and Development* (2005) pp. 13-20. Stiglitz expands this idea in chapter 5 of his 2006 book above n45, pp.133-159.

In July 2000, Stiglitz founded the *Initiative for Policy Dialogue* (IPD) with the express purpose to help developing countries explore policy alternatives, alternatives to the dominant neoliberal free-market ideology, and enable wider civic participation in economic policymaking.[48] By 2007, the IPD boasted about 250 members comprising distinguished economists, political scientists, policymakers, and civil society representatives from both the developed and the developing world.[49] Coordinated from its base at Columbia University, the IPD's network extends across a wide range of institutions in many parts of the world.[50]

The IPD pursues its objective through four programs: (1) Task Forces – which bring together experts from various countries to study complex, controversial economic issues and provide policy alternatives; (2) Country Dialogues – which assists in improving the quality of official decision-making on economic issues and open discussion to a broader audience and participants; (3) Journalism Workshops – which supports capacity building; and (4) Journalism Primer Research – designed to improve the intellectual foundation for

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[48] IPD Mission Statement at http://www0.gsb.columbia.edu/ipd/aboutus/index.cfm. <Accessed 12.10.07>.

[49] See the IPD Member Directory at http://www0.gsb.columbia.edu/ipd/aboutus/index.cfm. <Accessed 12.11.07>.

[50] These include Harvard University, University of California at Berkeley, Stanford University, Princeton University, the London School of Economics, Cambridge University, the University of Stockholm, the Hungarian Pension Guarantee Fund, the Center for Economic and Financial Research in Moscow, University of Delhi, University of Malaysia, Thailand's Ministry of Justice on Legal and Judicial Reform, the Africa Economic Research Consortium, the African Institute for Applied Economics, the Center of Studies for Institutional Development in Buenos Aires, and the Economic Commission for Latin America and the Caribbean in Chile. See the IPD Mission Statement at http://www0.gsb.columbia.edu/ipd/aboutus/index.cfm. <Accessed 12.10.07>.

debate on development issues. These programs are funded by a number of very reputable international institutions.[51]

Some of the important economic issues of the IPD dealt with through its Task Forces include bankruptcy, corporate finance, capital market liberalisation, debt restructuring, financial market reforms, governance of globalization, industrial policy, intellectual property, poverty, privatisation, the rule of law, tax, trade, transparency, and the resource curse.[52] In July 2005, the *Natural Resource Curse Task Force* held its first meeting at Columbia University. The Resource Course Task Force was chaired by Jeffrey Sachs, Macartan Humphreys and Stiglitz.[53] Humphreys, Sachs and Stiglitz edited and published the papers presented at that conference in a book entitled *Escaping the Resource Curse*.[54] The Open Society Institute provided financial assistance in the publication, translation and distribution of the book in multiple languages and in making it easily accessible to policymakers in a number of developing countries currently contending with the natural resource curse.[55] The contributors to that book argue that solutions to the resource curse do exist; yet institutional innovations are necessary to align the incentives of key

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[51] These are: (1) the Canadian International Development Agency (CIDA), based at Hull, Quebec, Canada; (2) Charles Stewart Mott Foundation, based at Flint, Michigan, USA; (3) Open Society Institute, New York, USA; (4) Rockefeller Brothers Fund, USA; (5) Swedish International Development Agency, Stockholm, Sweden; (6) The Ford Foundation, New York, USA; (7) The John D. and Catherine T. MacArthur Foundation, Chicago, Illinois, USA; (8) United Nations Development Programme (UNDP), New York, USA; and (9) United States Embassy in Vietnam.

[52] These are only some of the issues they dealt with. Others issues can be seen at http://www0.gsb.columbia.edu/ipd/aboutus/index.cfm.

[53] Sachs is an economics professor at Columbia University and heads the Earth Institute, whilst Humphreys is a political science professor also at Columbia.

[54] (2007).

[55] I was not able to obtain a copy of that book in Australia in 2007 or 2008.

domestic and international actors, and this requires fundamental political changes and much greater levels of transparency than currently exist.[56]

The IPD and its works are fast becoming popular among the developing world.[57] Therefore the number of partners and the popularity of the IPD programs are likely to draw more interests from civil society organisations, welfare groups and developing countries far into the future. Secondly, the number of partners, funders and institutions involved, and the reputation of individuals involved in the programs, like Jeffrey Sachs whose formal application of econometrics to the resource curse thesis popularised the thesis, and Stiglitz himself, give prestige and prominence of the seriousness and importance of the policy alternatives disseminated by the IPD.

D. The Open Society Justice Initiative and Legal Remedies for the Resource Curse.

On 17 February 2005, the Open Society Justice Initiative of the Open Institute of New York, USA, initiated a colloquium with legal advocates and policy professionals to examine legal remedies to curb large-scale corruption arising from natural resource

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[56] The book *Escaping the Resource Curse*, published by the Columbia University Press is not yet available at the library and local bookshops at this time of writing (2007). The information here is based on materials available on the homepage of IPD above n22.

[57] Global partners of the IPD to date include African Institute for Applied Economics (AIAE) - Enugu, Nigeria 2); Carnegie Council on Ethics and International Affairs New York - NY, United States; Centre for International Relations and International Cooperation - Barcelona, Spain; Centre for Pensions and Superannuation (CPS) - Sydney, Australia; Council for Social and Economic Development - Sao Paulo, Brazil; Fundacion Agenda Colombia - Bogota, Colombia; National Council of Applied Economic Research - New Delhi, India; Sheraton Pilar Hotel and Convention Center Pilar - Buenos Aires, Argentina; Social Science Research Council New York - NY, United States; The Center for Policy Alternatives in Serbia – Serbia; Third World Network (TWN) - Jalan Utama, Malaysia.

extraction, especially from Africa. The meeting was convened to address three specific questions:

- What is the present state of efforts to pursue legal remedies for corruption arising from the exploitation of natural resources, especially in Africa?
- Why has there not been any successful effort to secure legal remedies?
- Which legal strategies are particularly promising, and generally, what more could be done?

The deliberations at that meeting have been produced in a digest entitled *Legal Remedies for the Resource Curse: A Digest of Experience in Using Law to Combat Natural Resource Corruption* (the Digest).[58] The Digest concentrates on one particular type of corruption called *spoliation* - a term that describes the bribery of public officials by multinational corporations in resource-rich developing countries, and money laundering of these bribes or stolen proceeds from natural resources which are often held in secretive bank accounts and tax havens in developed countries.[59] In other words, *spoliation* concerns the sale or use of natural resources for the benefit of private actors, rather than

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[58] Open Society Institute (2005). This report is available online at http://www.revenuewatch.org/reports/legalremedies_20050906.pdf. <Accessed 15.10.07>.

[59] For an expanded definition, see Jennifer M. Hartman, 'Notes: Government by Thieves: Revealing the Monsters Behind the Kleptocratic Masks' (1997) 24 *Syracuse Journal of International Law and Commerce* p.24. For the original context in which the word *spoliation* was used, see Alexander Sidney Lanier, 'The French Spoliation Claims' (1924) 10 (1) *The Virginia Law Register*, New Series, pp.12-23; George A. King, 'The French Spoliation Claims' (1912) 6 (4) *The American Journal of International Law* pp.830-857; John MacArthur Maguire and Robert C. Vincent, 'Admissions Implied From Spoliation or Related Conduct' (1935) 45 (2) *The Yale Law Journal* pp.226-259.

for collective or public good.[60] Some commentators describe *spoliation* as *patrimonicide* or *grand corruption*,[61] or *prebendalism*[62] or *kleptocracy*.[63]

Prebendalism describes the situation where 'state officers are regarded as prebends that can be appropriated by office holders, who use them to generate material benefits for themselves and their constituents and kin groups'.[64] Conflict of interest or nepotism would fit the meaning of prebendalism.[65] Kleptocracy (*klepto* + *cracy*) literally means *rule by thieves*, meaning 'a government characterised by rampant greed and corruption.'[66] The e-JournalUSA online describes the global problem of kleptocracy as follows:

> Large-scale corruption by high-level public officials—kleptocracy—is a particular threat for democracy and rule of law in developing countries. Such corruption undermines financial accountability, discourages foreign investment, stifles economic performance, and diminishes trust in legal and judicial systems. According to the World Bank, $1 trillion is paid every year in bribes, and according to the United Nations, more than $400 billion has been looted from Africa alone and stashed away in foreign countries. Kleptocracy is a development issue, because high-level corruption undermines economic development and renders important issues, such as the fight against poverty, ineffective.

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60 Hartman, id., at p.9.

61 See for example, Paul D. Ocheje, 'Refocusing International Law on the Quest for Accountability in Africa: The Case Against the "Other" Impunity' (2002) *LJIL* p.749.

62 Edward Dommen, 'Paradigms of Governance and Exclusion' (1997) 35 (3) *The Journal of Modern African Studies* pp.485-494.

63 This word is believed to have been made popular by Stanislaw Andreski, 'Kleptocracy as a System of Government in Africa' in A. J. Heidenheimer (ed), *Political Corruption: Readings in Comparative Analysis* (1970) pp.346-57.

64 Richard Joseph, 'Nigeria: Inside the Dismal Tunnel' (May 1996) 95 (601) *Current History* p.193, at p.195.

65 Grabosky and Larmour, above n2, use *conflict of interest*, and Alatas, above n5, uses *nepotism*.

66 Definition taken from the online dictionary at http://www.answers.com/topic/kleptocracy. <Accessed 15.10.07>.

> In many parts of the world, kleptocrats have lined their own pockets instead of funding development, such as new roads, schools, and hospitals.[67]

The Open Society's initiative to find legal remedies therefore concerns *kleptocratic* corruption, *prebendalism* and *spoliation* as opposed to petty crimes of corruption that domestic criminal law and courts could handle. It is concerned about grand corruption, predatory states, kleptocrats and prebendalism involving especially three principal agents: (1) ruling elites of natural resource-rich host countries, (2) multinational corporations in the extractive industries, and (3) international banks and financial institutions.[68] The Digest observes that despite widespread and rampant practice of spoliation, legal response has remained relatively rare. For this reason, the Digest was not able to point to any generally uniform and accepted legal principle, code of practice or source of law that empowers victims of spoliation to seek legal redress. The Digest discusses nine case studies of spoliation in some resource-rich developing countries and the difficulties in seeking legal remedies.

The first case looks at bribery and oil money laundering between the ruling elites of Equatorial Guinea (Africa's third largest oil producer after Nigeria and Angola), transnational oil companies, and Riggs Bank based at Washington D.C. in the United States. The second case uncovers the bribery of African officials for oil contracts by Elf Aquitaine, France's national oil company, with the tacit support of its home government, before its merger with Total and Fina in 1994. The third case concerns criminal

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[67] e-JournalUSA online at http://usinfo.state.gov/journals/itdhr/1206/ijde/kleptocracy.htm. <Accessed 15.10.07>.

[68] The Digest, above n58, at p.10.

investigation undertaken by two France-based NGOs into allegations of spoliation by another French company in the logging industry in Cameroon. The fourth case discusses the difficulties a host country may face in prosecuting foreign corporations for corruption as demonstrated by Lesotho in a dam-building project.[69] The fifth, sixth and seventh cases look at Riggs Bank's role in setting up secret accounts for corrupt Third World rulers like those of Equatorial Guinea and Augusto Pinochet, Chile's former dictatorial President. The eighth case discusses the efforts of Nigeria to claim oil money held in secret Swish bank accounts in the name of the former dictator Sani Abacha who ruled Nigeria from 1993 until his death in 1998, and the legal hurdles the country faces. The final case looks at illegal shipment of iron ore from Liberia to a Chinese company notwithstanding a Liberian Supreme Court order prohibiting it. All these cases show that ruling elites in the poor South, transnational corporations, financial institutions and their home governments are involved in corruption and transfer of Third World natural resources wealth to the First World. These case studies support the underdevelopment theories rather than the resource curse thesis.

After presenting the above cases, and examining the legal weaknesses, challenges, complications and possibilities, the Digest makes four recommendations for governments to consider. First, the OECD Anti-Bribery Convention must be amended to accommodate corporate criminal liability, creation of robust oversight mechanisms, assert criminal jurisdiction over the commission of, and complicity in, spoliation crimes committed abroad. Victims of spoliation and civil associations acting on their behalf

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[69] See more on this see Fiona Daroch, *Lesotho Highlands Water Project: Corruption and Debarment* online at http://www.ipocafrica.org/cases/**highlands**/anticorrupt/corrdebar.pdf. <Accessed 17.10.07>.

must be given standing to present their cases in a judicial forum. Non-OECD homes of companies involved in transnational resources extraction should ratify and apply the Convention.

Second, the *Financial Action Task Force* (FATF) *Forty Recommendations on Combating Money Laundering* must be strengthened by encouraging governments who have not yet signed up to the FATF to adopt the recommendations. The FATF 'is an inter-governmental body whose purpose is the development and promotion of policies to combat money laundering – the processing of criminal proceeds in order to disguise their illegal origin. These policies aim to prevent such proceeds from being utilised in future criminal activities and from affecting legitimate economic activities.'[70] The FATF was formed in 1989.

Third, there is no binding international legal framework to prosecute multinational corporations for transnational crimes, especially in the extractive industries. Prosecution of companies is further complicated by a set of jurisdictional barriers that are costly for victims to challenge or impossible to surmount. In the natural resource sector, multinational corporations often commit corrupt activities through subsidiaries and shell companies which enable the parent companies to escape liability or responsibility. The UN Convention Against Corruption, the UN Global Compact, the OECD Anti-Bribery Convention, and the Council of Europe's Civil and Criminal Law Conventions on

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[70] F*ATF on Money Laundering*, online at http://fincen.gov/40rec.pdf. <Accessed 17.10.07>. The 40 recommendations and other particulars of the FATF are provided in that document. The work and activities of FATF can be found in its annual reports. The 2006-2007 Annual Report can be downloaded from http://www.fatf-gafi.org/dataoecd/46/1/39162982.pdf. <Accessed 17.10.07>.

Corruption represent nascent accountability framework, but these instruments require stronger enforcement mechanisms. Moreover, they only bind parties to these treaties, and non-parties should be encouraged to ratify.

Fourth, Bank secrecy laws and inadequate freedom of information provisions present significant obstacle to the pursuit of institutions that engage in money laundering. Host and home countries should provide and improve legislation requiring disclosure of revenues and activities of both government and corporate actors, as recommended by the Extractive Industries Transparency Initiative and the Publish What You Pay campaigns. In relation to money laundering in the extractive industries, bank secrecy rules must be reformed, while maintaining genuine privacy provisions. Law must allow investigators and prosecutors to access relevant bank records.

For donors and NGOs, first it is useful to note that, in resource-rich developing countries whose governments are complicit in spoliation, recovering the lost wealth is possible only after a political transition. Therefore, NGOs need to move and act fast to preserve evidence and overcome short statutory time limitations. Local lawyers need to interact with international civil society organizations to discuss expeditious strategies to preserve evidence, collate information, and receive additional training in preparation for, and prosecution of, spoliation crimes.

Second, a revolving global fund should be created to mitigate and overcome cost hurdles in successfully mounting investigations and tracking stolen assets. This fund would

allow new and transitional governments to retain the professional expertise of lawyers, forensic experts, and investigators needed to retrieve stolen money.

Third, civil society groups could do a number of things to combat transnational spoliation. These include: (1) advocating legal reforms in both host and home countries of transnational corporations engaged in the extractive industries; (2) investigating cases of corruption and providing information to the media and prosecutors; (3) identifying suitable plaintiffs and victims; (4) launching civil litigation; (5) filing criminal complaints (and in some countries) pursuing criminal prosecutions; and (6) submitting petitions to intergovernmental bodies. NGOs can also train lawyers and pursue freedom of information requests in host and home countries. They can call on their respective governments to ratify and implement relevant international treaties and declarations, and call for tougher sanctions and to put in place transparent and accountable regional and international legal frameworks.

IV. EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE (EITI).

The EITI was launched by Great Britain's Prime Minister Tony Blair at the World Summit on Sustainable Development in Johannesburg in September 2002. The sole objective of the EITI is '*to increase transparency over payments and revenues in the extractive sector in countries heavily dependent on these resources*.'[71] The EITI is based on the belief that sustainable and prudent use of natural resources has the potential to cause sustainable economic growth and development. To realize this potential, the

[71] See this statement and other policy objectives of the EITI on it home page at http://www2.dfid.gov.uk/news/files/eitireportconference17june03.asp. <Accessed 17.10.07>. Emphasis added.

Initiative encourages governments, companies and civil society organizations to work together voluntarily to develop a framework to promote transparency of revenue receipts and payments. The EITI *Source Book* explains the role of the EITI as follows:

> In many countries, money from oil, gas and mining is associated with poverty, conflict and corruption. Commonly referred to as the "resource curse", this is often driven by a lack of transparency and accountability around the payments that companies are making to governments, and the revenues that governments are receiving from those companies. The Extractive Industries Transparency Initiative (EITI) seeks to create that missing transparency and accountability. It is a voluntary initiative, supported by a coalition of companies, governments, investors and civil society organizations. Alongside other efforts to improve transparency in government budget practice, the EITI begins a process whereby citizens can hold their governments to account for the use of those revenues.[72]

At the G8 summit in Evian, Switzerland, from 1-3 June 2003, leaders from the world's wealthiest nations endorsed the Johannesburg initiative to fight corruption and improve transparency in the extractive industries. The G8 leaders reiterated:

> We emphasise our determination to fight corruption and mismanagement of public resources in both revenue raising and expenditures. Transparency inhibits corruption and promotes good governance. Increased transparency of government revenue and expenditure flows, as well as strengthened enforcement efforts against bribery and corruption, will contribute to achieving these goals and to increasing integrity in government decision-making - thereby ensuring that resources, including development assistance, achieve their intended purposes.[73]

[72] EITI Secretariat in the UK Department of International Development, *Extractive Industries Transparency Initiative Source Book* (2005) p.2. This book is available online and can be downloaded from http://www.eitransparency.org/UserFiles/File/keydocuments/sourcebookmarch05.pdf. <Accessed 16.10.07>.

[73] G8, *Fighting Corruption and Improving Transparency: A G8 Declaration* online at http://www.g8.fr/evian/english/navigation/2003_g8_summit/summit_documents/fighting_corruption_and_improving_transparency_-_a_g8_action_plan.html. <Accessed 17.10.07>.

The G8 leaders declared that they would improve public financial management and accountability to ensure that public and donor resources are used efficiently and effectively. They continued: 'We will…focus bilateral assistance on countries demonstrating commitment to improve performance on transparency, good governance and rule of law…'[74] The leaders agreed to an action plan that includes piloting, on a voluntary basis, an intensified approach to transparency in oil, gas and mineral-dependent developing and transition countries.

The six declarations on ways to combat corruption and improve transparency adopted at Evian was later announced at the 17 June 2003 Lancaster conference on EITI. Among other things, Prime Minister Blair in his opening speech reasoned that 'lack of transparency undermines public confidence in the legitimacy of states. When there is corruption, it is always the poor who suffer most. We need to use transparency in revenue and financial management to allow people to hold government to account and build public trust. Increased transparency will also help create the right climate for attracting foreign investment, and encourage an enterprise culture.'[75] The EITI is an ongoing program helping to develop concrete measures to implement this plan.[76]

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[74] G8, ibid.

[75] Ibid.

[76] Twelve *Principles* to guide its activities adopted at the 17 June 2003 Lancaster conference are: (1) We share a belief that the prudent use of natural resource wealth should be an important engine for sustainable economic growth that contributes to sustainable development and poverty reduction, but if not managed properly, can create negative economic and social impacts. (2) We affirm that management of natural resource wealth for the benefit of a country's citizens is in the domain of sovereign governments to be exercised in the interests of their national development. (3) We recognise that the benefits of resource extraction occur as revenue streams over many years and can be highly price dependent. (4) We recognise that a public understanding of government revenues and expenditure over time could help public debate and inform choice of appropriate and realistic options for sustainable development. (5) We underline the importance of transparency by governments and companies in the extractive industries and the need to enhance public financial management and

Participants at the Lancaster conference were encouraged to work in support of the objectives and actions of the EITI, provided they are consistent with each participant's individual functions and objectives.[77]

Following the Lancaster conference, some countries agreed to implement transparency, accountability, and good governance programs by publicising *payments* to, and *revenues* received from, the extractive industries. These countries are Azerbaijan, Congo, Ghana, Kyrgyz Republic, Nigeria, Peru, Sao Tome e Principe, East Timor, and Trinidad and Tobago. By 2005, progress in these countries was slow except in Kyrgyz Republic which published its oil revenue figures in line with EITI guidelines.[78] On 17 March 2005, the EITI participants met at London to report on the progress to date and discuss future plans.

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accountability. (6) We recognise that achievement of greater transparency must be set in the context of respect for contracts and laws. (7) We recognise the enhanced environment for domestic and foreign direct investment that financial transparency may bring. (8) We believe in the principle and practice of accountability by government to all citizens for the stewardship of revenue streams and public expenditure. (9) We are committed to encouraging high standards of transparency and accountability in public life, government operations and in business. (10) We believe that a broadly consistent and workable approach to the disclosure of payments and revenues is required, which is simple to undertake and to use. (11) We believe that payments disclosure in a given country should involve all extractive industry companies operating in that country. (12) In seeking solutions, we believe that all stakeholders have important and relevant contributions to make - including governments and their agencies, extractive industry companies, service companies, multilateral organisations, financial organisations, investors and non-governmental organisations. See this list at http://www.pfmc.az/cl2_fmc/files/2004/05/01/100609331_1.doc. <Accessed 17.10.07>.

[77] These are (1) developing and testing methods of payment and revenue disclosure and publication in the extractive industries in countries heavily dependent on natural resources, wherever the government has decided to do so; (2) working at the country level to implement reporting guidelines consistent with EITI principles, agreed between each host government and companies working in its country, along with support from civil society, international institutions and other relevant players; (3) In piloting this approach, the EITI reporting guidelines will provide the basis for country-level procedures to ensure transparency in company payments and government revenue; (4) developing effective links to other initiatives and actions designed to tackle corruption and improve transparency; (5) incorporating the principles of EITI into relevant, guidelines or operational policies, wherever appropriate; (6) mobilising, where appropriate, technical advice, expertise and support for capacity building to help stakeholders implement and review the EITI; (7) considering in what other ways, the objectives of the Initiative may be pursued; (8) encouraging, whenever appropriate, companies, governments, and other interested parties to join the Initiative to develop effective and lasting solutions; and (9) keeping progress of the Initiative under regular review.

[78] EITI Press Release, online at www.dfid.gov.uk/news/files/pressreleases/pr-eiti**conference17**mar05.pdf. <Accessed 17.10.07>.

All participants affirmed their commitment to the EITI *Principles* and agreed to publish what extractive industry companies pay to their governments as a first step towards transparency and accountability. The participants then endorsed six principles called EITI *Criteria*, which would assist them in obtaining and publishing resource revenues.[79]

Since its launch in 2002, the EITI has been coordinated by the government of Great Britain through its Department for International Development. At the 2005 London conference, the EITI established an international advisory group (IAG) to guide, define, refine and devise future plans of the EITI. That arrangement was modified after the EITI conference in Oslo from 16-17 October 2006. The Oslo conference established a Board drawn from governments, companies and civil society groups. EITI *supporting countries* on the Board are Germany, United States and the United Kingdom. France, Norway and Australia serve as alternates. The EITI *implementing countries* represented on the Board are Azerbaijan, Gabon, Guinea, Kyrgyz Republic and Nigeria. Ghana, Cameroon and Kazakhstan serve as alternates. Representatives on the Board from extractive companies are British Petroleum (BP), Chevron-Texaco, Anglo-American, International Council on

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[79] These are (1) Regular publication of all material oil, gas and mining payments by companies to governments ("payments"), and all material payments received by governments from oil, gas and mining companies ("revenue") to a wide audience in a publicly accessible, comprehensive and comprehensible manner. (2) Where such audits do not already exists, payments and revenues are the subject of a credible, independent audit, applying international audit standards. (3) Payments and revenues are reconciled by a credible, independent administrator, applying international auditing standards and with publication of the administrator's opinion regarding that reconciliation including discrepancies, should any be identified. (4) his approach is extended to all companies including state-owned enterprises. (5) Civil society is actively engaged as a participant in the design, monitoring and evaluation of this process and contribute towards public debate. (6) A public, financially sustainable work plan for all the above is developed by the host government, with assistance from the international financial institutions where required, including measurable targets, a timetable for implementation, and an assessment of potential constraints. EITI London Conference on 17 March 2005 – *Statement of Outcomes* online at http://eitidev.forumone.com/UserFiles/statementmarch172005.pdf. <Accessed 17.10.07>.

Mining and Metals, and Pemex. Exxon Mobil, Shell and Petrobras serve as alternates.[80] The IMF, the World Bank and the African Development Bank have observer status.[81] The EITI 's Secretariat office has been moved from London to Oslo.

A Multi-Donor Trust Fund (MDTF) has been established to provide financial support to countries seeking to implement EITI. The MDTF is administered by the World Bank. A Management Committee comprising the World Bank and governments who have contributed in excess of $500,000 to the MDTF sets the work plan of the MDTF. In 2007, the United Kingdom, Norway, the Netherlands and Germany have contributed that amount and are therefore qualified to be on the Management Committee.[82] The EITI Secretariat is expected to take a role as a full member of the MDTF to reflect the views of the EITI Board in Management Committee discussions.[83] By October 2007, 21 resource-rich developing and transition countries have signed up to implement the EITI,[84] and eight are considering joining.[85] Norway is the first and only developed and promoting country to have signed up to adopt and implement the EITI.[86] The IMF, the World Bank, the G8 and OECD countries, and some oil and mining transnational corporations and civil society groups are working together to implement the EITI.

80 For these Oslo events, see http://www.eitransparency.org/section/events/_oslooctober2006. <Accessed 17.10.07>.

81 See the EITI homepage at http://www.eitransparency.org/. <Accessed 17.10.07>.

82 In January 2007, the Secretary of State for International Development told the House of Commons that Great Britain has so far contributed 4.5 million pounds. See http://www.publications.parliament.uk/pa/cm200607/cmhansrd/cm070116/text/70116w0001.htm. <Accessed 18.10.07>.

83 Draft Terms of Reference for the EITI Board, online at http://www.eitransparency.org/UserFiles/File/iaglondon/**board**torsaugust.pdf. <Accessed 17.10.07>.

84 See EITI news at http://www.eitransparency.org/content/article/detail/899. <Accessed 18.10.07>.

85 Eight countries are still considering ways to implement the EITI: see http://www.eitransparency.myaiweb15.com/docs/iagcountryupdateoct05.pdf. <Accessed 22.10.07>.

86 United Press International, online at http://www.upi.com/International_Security/Energy/Briefing/2007/09/27/norway_signs_antioil_corruption_treaty/6331/. <Accessed 15.10.09>.

V. ANALYTICAL COMMENTS

In the view of this thesis, the Open Society's Digest supports underdevelopment economics by identifying that the resource curse is caused by dependent Third World ruling elites and transnational corporations with the backing of their home governments and financial institutions who transfer natural resource wealth from the poor South to the rich North in the world capitalist system. As the Digest notes, there are no effective legal instruments to curb this capital flight. Despite much theorising, the IMF and the World Bank, and the resource curse theorists concentrate only on Third World governments and not the transnational corporations and financial institutions who are party to the cause of the resource curse. Stiglitz and his IPD have, like the NGOs, identified corruption to be an international problem involving corporations, governments and financial institutions.

The resource curse theorists identify not only corruption and rent-seeking, but also lack of diversification, trade closer, and lack of human resource development as being important. In fact, in the intellectual contest between *good institutions*, *open trade*, and *human education*, some have trumped education as the best remedy to the resource curse as we saw in Chapter Three. Yet, the *transparency* and *good governance* crusade, which support the *institutional* theories, seem to inform and persuade the global actions outlined above. This thesis submits that this is largely due to the influence of the IMF, the World Bank, and the OECD countries in blaming Third World corruption and dictating what these poor countries should do to combat the resource curse. While no doubt the global actions are commendable, one can also argue that the 'lecturing' on good governance and transparency is nothing more than an intellectual aspect of neocolonialism.

In this thesis, no *one-size-fits-all* solution can be found for the resource curse. This is to say that transparency and good governance may be good solutions for some resource-rich developing countries but not all. In the case of countries like PNG, it is human education that is critical. In PNG, majority of the country's population are illiterate. Consequently, all the strategies and initiatives to mobilise the population to have access to information on resource revenue to monitor government use of those funds will not be effective. Hence, first, a people must be educated so that they can know what they are talking about and fighting for. They must be literate to know their rights and obligations, and the duties and responsibilities of governments towards them. Only then can they demand transparency and good governance. From this standpoint, education should become a pre-requisite in the fight against corruption in PNG instead of transparency and good governance.

The United Nations Development Program (UNDP) understands the critical importance of human development in economic development. For the UNDP, 'people are the real wealth of nations.'[87] Without education, not only that people's choices are limited, but also, they cannot make informed choices. Therefore, this thesis reiterates that it is not transparency and good governance, but education that is the key to combat the resource curse. Transparency and good governance, though good concepts as they may be, are not useful if they are imposed from outside on a largely uneducated population as in PNG. Ideas about development and the need to deal with the curse must thus spring from within a resource-rich country by its own educated people. International groups should support

[87] UNDP, *What is Human Development*, at http://hdr.undp.org/hd/. <Accessed 23.10.07>.

the domestic efforts. Otherwise imposition of *private policies* made abroad is nothing more than corruption in the new economic sense as we saw in Chapters Five and Six.

While global efforts to deal with the resource curse by civil NGOs pursue 'good Samaritan' principles, in the view of this thesis many others such as that championed by the OECD and international financial institutions like the IMF are not. This thesis holds such a view based on reading the intention between the lines in many transparency and good governance reports. For instance, the March 2007 Global Witness Report mentioned above reveals that transparency and good governance is required because corruption and kleptocracy 'foster political unrest and threaten oil supplies.'[88] This means that because Third World corruption poses a significant risk to the vital interests of transnational corporations and their home governments, governments of Third World countries must be monitored to ensure they use their oil and mineral revenue to silence their people. That seems to be the motivating factor for the resource curse theorists uniting with and joining the bandwagon of the 'good Samaritan' non-resource curse theorists and NGOs fighting corruption behind the transparency and good governance banner.

VI. CONCLUSION

Since corruption is a serious problem in resource-rich peripheral countries, it is encouraging to see a united effort by host and home governments, the Bretton Woods institutions, NGOs and transnational corporations to combat it. Despite these efforts,

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[88] Global Witness, *Oil Revenue Transparency: A Strategic Component of U.S. Energy Security and Anti-Corruption Policy* (March 2007) p.4.

corruption is still thriving. The March 2007 Global Witness report highlights not only the seriousness but also the continuation of corruption in the following words:

> The 'resource curse' of oil-related corruption leading to poverty and instability rather than economic development continues in a great many oil-rich nations today. Despite global oil prices reaching record highs over the past year, the population of many oil-rich countries are still not benefiting. In Nigeria over 90% of the population lives on less than $2 a day, in Venezuela poverty has increased over the past 25 years despite $600 billion in oil revenues during that period, and over half of oil-rich Equatorial Guinea's citizens survive on less than $1 per day. Governments of numerous resource-rich countries are notoriously reluctant to publicly disclose how much revenue they receive from their extractive industries or how they spend these revenues. In all, 26 of the world's 36 oil-rich countries rank among the bottom half of the world's most corrupt countries.[89]

Blaming corrupt governments in developing countries and ignoring the part played by transnational corporations, banks and other financial institutions, and governments in the developed countries will not solve the resource curse. In my view, prohibiting foreign investment in the extractive sector, and leaving natural resources in the ground as Stevens suggests (Chapter Five) until local businesses in developing countries exploit these resources themselves as the legal explanations of the RCT recommend, is the best solution to underdevelopment or the resource curse. This solution would then enable diversification through resource-based industrialisation as espoused by structuralism of underdevelopment economics. Human education is thus a pre-requisite to implement such a policy.

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[89] Ibid.

CHAPTER EIGHT

CAPITAL FLIGHT AND THE CURSE OF NEOLIBERALIZATION

We are ... a race of robbers and spoilers.[1]

INTRODUCTION

As we saw in Chapter Two, Richard Auty correctly identifies that because of the enclave nature of the extractive industry and its high dependence on foreign capital, technology and skills, *capital flight* occurs and contributes to the resource curse. However, no orthodox explanation or theory we have seen so far deals with *capital flight* and how it occurs. Therefore, in this chapter we will look at various forms of *capital flight* and how they occur. Section I examines *traditional* causes of *capital flight*. These are (1) irrelevant and unrealistic development policy assumptions, (2) odious debts, (3) export credit agencies (ECA), (4) foreign aid, and (4) money laundering and tax evasion. Section II explores *neoliberal* causes of capital flight through (1) privatisation, (2) financial liberalisation and (3) trade liberalisation. Section III provides a summary by way of conclusion. The purpose of the chapter is to show that these various forms of capital flight support the causes and explanations provided by underdevelopment economics rather than those provided by the resource curse thesis.

I. TRADITIONAL CAUSES OF CAPITAL FLIGHT

A. Irrelevant and Unrealistic Policy Assumptions

Oxford economics scholar Dr. Ha-Joon Chang argues that orthodox development policies prescribed to developing countries from modernisation theory promoting the role of

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[1] Deryck Scarr, *The History of the Pacific Islands: Kingdoms of the Reefs* (1990) p.234.

foreign direct investment (FDI) to neoliberal theories and to the Washington Consensus are designed to cause *capital flight* and '*kick away the ladder*' that could lead developing countries to industrialisation and prosperity.[2] Lance Taylor, economics professor at The New School in New York City, commenting on Chang's claim admits: 'People have 'always known' that leading economies used directed policies to industrialize when they were less affluent and then told poorer countries NOT to do the same, i.e. the incumbent rich always tell the poor to adopt a liberal policy stance.'[3] One of the policies that the affluent countries have not followed, and do not follow even today, is to encourage FDI in their *extractive industries*.[4]

Why then do orthodox development advocates recommend developing countries to promote FDI in their extractive industries? According to Dr. Chang's reasoning, it is to prevent developing countries from becoming as industrialised and powerful as the rich developed nations. Dr. J. W. Smith, an economics historian, support this construction by pointing out that many highly trained professionals from the *imperial-centres-of-capital* working as advisors, educators, instructors and experts in various capacities in developing countries indeed mislead leaders of these countries.[5] John Perkins, who worked as chief economist of an American corporation Chase T. Main Inc. (MAIN) in some resources-rich developing countries like Indonesia, Saudi Arabia, Iran and Latin

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[2] Ha-Joon Chang, *Kicking Away the Ladder: Development Strategy in Historical Perspective* (2003).

[3] Quoted in the review page of Chang's book, ibid.

[4] Strong and passionate opposition against Chinese corporations such as Chinalco seeking to buy non-controlling shares worth 10% or below in Australian mining companies in 2008-2009 demonstrates this point.

[5] I am borrowing J.W. Smith's *imperial-centres-of-capital* to describe what Wallerstein calls *core* in his core-periphery model in his *Economic Democracy: The Political Struggle of the Twenty-first Century*, (4th ed, 2005).

America and who describes himself as an *economic hit man* (EHM) indeed confesses to causing these countries to accept policies that trapped them in debts traps.[6]

Perkins was compelled to confess his actions as a result of the terrorist bombing of the World Trade Center in the United States on 11 September 2001. Perkins defines economic hit men (EHM) as

> highly paid professionals who cheat countries around the globe out of trillions of dollars. They funnel money from the World Bank, the U.S. Agency for International Development (USAID), and other foreign "aid" organizations into the coffers of huge corporations and the pockets of a few wealthy families who control the planet's natural resources. Their tools include fraudulent financial reports, rigged elections, payoffs, extortion, sex, and murder. They play a game as old as empire, but one that has taken on new and terrifying dimensions during this time of globalization. I should know; I was an EHM.[7]

In a confidential meeting with a 'special consultant' to MAIN, Perkins was instructed to pursue two primary objectives. First, to persuade resource-rich developing countries to take out huge loans for major engineering and construction development projects, which would be carried out by MAIN and other U.S. companies such as Bechtel, Halliburton, Stone & Webster and Brown & Root, and justify these loans with impressive growth projections. His work involved producing reports that showed the *economic growth* the country would experience due to these projects. Perkins observes that the *gross national product* (GNP) became the most important and deceptive tool in the growth projections that trapped developing countries. Perkins' second role was to bankrupt the borrowing countries by ensuring that they remained indebted to their creditors in order to make them

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[6] John Perkins, *Confessions of an Economic Hitman: The Shocking Inside Story of How America Really Took Over the World* (first published 2004, 2005 ed).

[7] Id., p.ix.

easy targets when the U.S. needed favors such as military bases, UN votes and access to natural resources like oil.[8]

All the big projects were meant to make huge profits for the U.S. contractors. At the same time, the host countries were made to believe that the projects would cause a 'big push' in economic development and speed up their industrialisation efforts. In reality, however, only a few ruling elites were enriched, which helped them to bolster their political power. These leaders were credited with bringing industrial parks, power plants and airports to their people. Today, the ultimate result of these loans is that money flows from the poor South to the rich North in debt service while the poor citizens are deprived of health, education and other social services. Meanwhile, the Western media and development experts portray these projects as favors being provided by the industrialised world. Western citizens in general have no trouble believing these messages, and in fact are led to perceive that these actions are unselfish acts of international goodwill. And thanks to these large debts, the West is able to draw on debt-burdened countries for political, economic and military favors whenever needed.

Perkins points out that if the EHM's job failed, then 'jackals' are used, and failing that, military intervention is the last resort.[9] '*Jackals are C.I.A.-sanctioned people that come in and try to foment a coup or revolution. If that doesn't work, they perform assassinations, or try to*.'[10] Perkins provides the case of Iraq as an example: 'Our jackals tried to take out Saddam, but his security forces were too good, loyal… That's why Bush

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8 Id., at p.15.
9 Id., at p.xiii.
10 *CIA Jackals and World Bank Wolfowitz* (Tuesday 17 March 2005) http://argentina.indymedia.org/news/2005/03/274302.php. <Accessed 16.06.08>.

sent in the army.'[11] Economic hit men, jackals and military intervention are employed by what Perkins calls the *corporatocracy* comprising corporations, banks and the U.S. government. This corporatocracy uses its financial and political muscle to promote the concept of *economic growth* as if it is the gospel truth that benefits all humankind when in fact it enriches only the corporatocracy. As he puts it, resources exploitation is driven not by a conspiracy but by something far more dangerous than conspiracy. '*It is driven…by a concept that has become accepted as gospel: the idea that all economic growth benefits humankind and that the greater the growth, the more widespread the benefits. This belief also has a corollary: that those who excel at stocking the fires of economic growth should be exalted and rewarded, while those born at the fringes are available for exploitation*.'[12]

While orthodox academics generally rely on modeling and assumptions, Perkins was involved in implementing the 'big push' ideology of modernisation theory. Hence, his account is more credible than grand theories and assumptions based on modelling. Perkins admits that many critiques have dismissed his account as unbelievable and unsubstantiated allegations of a lone voice. In response, he and his publisher gathered a group of highly reputable persons many of whom had personal involvement in the service of the *corporatocracy* to explain the various ways by which developing countries are plundered and made dependent.[13] These contributions were published in 2007 in a book entitled *A Game as Old as Empire: The Secret World of Economic Hit Men and the Web*

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[11] John Perkins, *The Secret History of the American Empire: Economic Hit Men, Jackals, and the Truth About Global Corruption* (2007) p.89.

[12] Id., p.xii. Emphasis added.

[13] Steven Hiatt, 'Global Empire: The Web of Control' in Steven Hiatt (ed, with a *Foreword* by Bernie Fraser, and an *Introduction* by John Perkins), *A Game as Old as Empire: The Secret World of Economic Hit Men and the Web of Global Corruption* (2007) pp.21-43, at p.30.

of Global Corruption, edited by Steven Hiatt. We will refer to some of these contributions later in this chapter.

Here, it suffices to note that Perkins's confession makes sense. The 'big push' ideology of modernisation discourse and the ambitious assumption of economic growth justified the borrowing of loans, and encouragement of FDI into the natural resources sector. However, the motive on the part of the corporatocracy was to use the loan as a tool of neocolonialism and secure access to cheap sources of raw materials. One of the tragic consequences is capital flight from the poor South to the rich North in the form of debt service. According to one conservative estimate, Third World debt service amounts to more than US$375 billion per year, about twenty times the amount of foreign aid Third World countries receive annually.[14]

B. Odious Debts

A substantial part of the Third World debt burden comprises what is called *odious debts* at international law. Alexander Sack's definition of odious debt, which is the most comprehensive and generally accepted, can be summarised as comprising two essential elements. First, the debt is incurred by a *despotic regime*, *not for the needs or in the interest of the state*, but rather to strengthen itself, to suppress a popular resurrection, and maintain its rule.[15] Second, the *lender has knowledge* of the fact that the loan advanced is obtained not for the interest of the nation or its people. In this sense, *the lenders have committed a hostile act against the people*, and they cannot expect a nation, which has freed itself from a despotic to assume the odious debts, even if the despotic is overthrown

[14] Id., at p.29.
[15] Alexander Sack, quoted by Jeff A. King, 'The Doctrine of Odious Debt in International Law: A Restatement' (Keble College, Oxford University, 21 January 2007) at p.16.

by another despotic. The debt must remain a personal debt and can not attach to the state.[16] Some recent researchers however identify three types of odious debts:

- *Hostile Debts*: debts that are actively aggressive against the interests of a population (e.g. conquest, colonisation, war, suppressing secessionist attempts).
- *War debts*: debts contracted by a state for the purpose of funding a war, which it eventually loses. The victor is not considered obliged to pay.
- *Third-World Debts Not in the Interests of the Population*: This title refers to the new category of debts that were neither hostile nor war debts, but were simply harmful burdens assumed by a state but for which the population received no benefit.[17]

For a long time odious debt has been of very little interest among development researchers until recently when the removal of Saddam Hussein in 2003 caused the U.S. government to search for legal justifications to dispose of Iraq's debt secured under the Hussein regime. Secondly, civil rights movements have recently intensified their call for odious debt cancellation. These two voices has sparked frantic research and heated debate on the issue.[18] Civil society groups and many commentators argue that

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[16] Ibid.

[17] Ashfaq Khalfan, Jeff King and Bryan Thomas, 'Advancing the Odious Debt Doctrine' (Centre for International Sustainable Development Law (CISDL) Working Paper, Montreal: CISDL, 2003).

[18] The World Bank, 'The Concept of Odious Debt: Some Considerations' (PRMED Discussion Paper, (World Bank, Washington D.C., 7 September 2007); Michael Kremer and Seema Jayachandran, 'Odious Debt: Preliminary' (Harvard University: April 2002); Christiana Ochoa, 'From Odious Debt to Odious Finance: Avoiding the Externalities of a Functional Odious Debt Doctrine' (2008) 49 (1) *Harvard International Law Journal* pp.109-159; Vikram Nehru and Mark Thomas, 'The Concept of Odious Debt: Some Considerations' (Economic Policy and Debt Department Discussion Paper, World Bank Washington D.C., 22 May 2008); African Forum and Network on Debt and Development (AFRODAD), *The Illegitimacy of External Debts: The Case of the Republic of Congo: Final Report*, dated 2005 online at http://www.afrodad.org/downloads/publications/Illegitimate%20Debts%20-%20DRC.pdf. <Accessed 17.06.08>; Mitu Gulati, Sarah Ludington and Mark Weisburd, 'A Conventional Untruth: Fact and Fantasy in the Doctrine of Odious Debts (with response: Reflections on 'a Convenient Untruth')' (Duke Law School Working Paper Series, Paper 104, Duke University Law School, 2007); Lee C. Buchheit, G. Mitu Gulati and Robert B. Thompson, 'The Dilemma of Odious Debt' (March 2007) 56 (5) *Duke Law Journal* pp.1201-1262; Ashfaq Khalfan, Jeff King and Bryan Thomas, 'Advancing the Odious Debt Doctrine' (Centre for International Sustainable Development Law Working Paper, (Montreal: CISDL, undated), online at http://www.cisdl.org. <Accessed 16.06.08>; Patrick Bond, 'African Development/Governance, South African Subimperialism and Nepad' (Paper presented to IDEAs, Ethiopian Economic Association and the Council for the Development of Social Science Research in Africa Conference on the Agrarian and Poverty Reduction, Addis Ababa, Ethiopia, 17-19 December 2004); Yovana Reyes Tagle and Katarina

international financial institutions (IFIs), which made loans to dictatorial regimes, although with the full knowledge that the money would not be used for the benefit of the state and its people, are odious and must therefore be cancelled.[19] According to these arguments, demanding poor Third World citizens to repay odious debts is not only unjust and unfair, but also illegal at international law.[20]

Two former EHM Perkins and his publishers engaged to explain how odious debts were created are Gwynne, who worked for an American private bank, and Berkman, who worked for the World Bank. First, Gwynne explains that when he was a young 25 year old without any experience in international lending, he was compelled by his American bank employer to facilitate a loan to a private construction company in the Philippines in the 1970s during the reign of Ferdinand Marcos.[21] With the guarantee of the central bank of the Philippines, US$10 million was funneled through, with the full knowledge that the construction company's ability to repay was uncertain. Shortly after negotiating this loan, Gwynne left to join another bank. By the time the Marcos regime was overthrown by popular revolt in 1986, the foreign debt of the Philippines had exceeded US$28 billion, of which $675 million was owed to companies run by Marcos' cronies, which

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Sehm Patomaki, 'The Rise and Development of the Global Debt Movement: A North-South Dialogue' (Civil Society and Social Movement Programme Paper No. 28, United Nations Research Institute for Social Development, Geneva, January 2007); Daniel K. Tarullo, 'Odious Debt in Retrospect' (2007) 70 *Law & Contemporary Problems* pp.263-274; Patrick Bolton and David Skeel, 'Odious Debts or Odious Regimes?' (2007) 70 *Law & Contemporary Problems* p.83; James V. Feinerman, 'Odious Debt, Old and New: The Legal Intellectual History of an Idea' (2007) 70 *Law & Contemporary Problems* p.193; Kunibert Raffer, 'Odious, Illegitimate, Illegal, or Legal Debts – What Difference Does it Make for International Chapter 9 Debt Arbitration?' (2007) 70 *Law & Contemporary Problems* p.221; Joseph E. Stiglitz, 'Odious Rules, Odious Debts' (November 2003) *Atlantic Monthly* p.39.

[19] Jubilee USA Network, *G-8 Summit 2004: Iraq's Odious Debt Rhetoric to Reality* online at http://www.jubileeusa.org/press_room/iraqdebt.pdf. <Accessed 18.06.08>.

[20] The legal history of odious debt is traced back to the debt cancellation of Cuban debt after the Spanish-American war, which is ably discussed by many of the sources above.

[21] S. C. Gwynne, 'Selling Money – and Dependency: Setting the Debt Trap' in Hiatt (ed), above n13, pp.45-57.

could qualify as odious.[22] Yet, the Philippines has been demanded to pay, and the Aquino regime has bowed down to U.S. pressure to accept, these odious debts, which it is still paying today.[23] Similar odious debt incurred during the Suharto regime in Indonesia which was estimated to be $262 billion in 2002, then equivalent to 170 percent of its gross domestic product, burdens that country.[24] While Iraq's odious debts incurred by Sadam Hussein are discussed because it negatively affects U.S. interests, other countries like the Philippines, Indonesia and Nigeria are still made to pay odious debts without much debate.

Gwynne explains that the root of Third World debt is the violation of the oldest rule of lending on the part of the lending institutions. From his experience, 'American banks frequently violate the oldest precepts of lending against security.' [25] Gwynne continues: '*As a domestic credit analyst, I was taught to develop reasonable asset security for all loans, unless the borrower was of impeccable means and integrity. As an international loans officer, I was taught to forget about all that, and instead to develop a set of rationales that would make the home office feel good and the loan, even though, technically, it was unsecured.*'[26]

Gwynne was instructed that the ability to repay was no longer a main consideration in international lending. Instead, the most important consideration was '*access to the marketplace*', meaning the ability to borrow even more. The theory was that '*as long as a country can continue to borrow money, it will in effect, be able to roll over its debt*

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22 Id., at pp.56-7.

23 Ellen Augustine, 'The Philippines, the World Bank and the Race to the Bottom' in Hiatt (ed), above n13, pp.245-272, at p.253.

24 John Pilger, *The New Rulers of the World* (2002) p.43.

25 Gwynne, above n21, at p.51.

26 Ibid. Emphasis added.

indefinitely, in much the same manner as the U.S. government rolls the national debt. As long as the country can roll its debt, the banks will be repaid on schedule and the country will not become insolvent.'[27] American banks firmly believe that '*banks and governments won't default*.'[28] With this belief, the banks ignored their responsibility to make sure that their loans were used productively to finance large-scale industrial or other projects designed to improve productivity of the national economy.[29]

One can appreciate that the sub-prime mortgage crisis that has sparked the current international financial crisis since 2007 was caused by the *access to the market* ideology that Gywnne entails here. Once the Third World was tethering on the debt burden and reduced their borrowing as a result, the financial vultures turned to vulnerable borrowers in their home countries and lent out without regard to the oldest precept of lending against security. Consequently, bank collapses, factory closures and massive lay-offs of employees in the First World is replicating what has been happening in the Third World for decades.

Second, Berkman (former World Bank staff who joined the Bank's Africa Region Group in 1983 until his retirement in 1995) also asserts that the World Bank adopts the same attitude of the American banks, that *governments will not default*, and *access to the marketplace* without regard to security are all that matter. In his words:

> Fostering a culture of lending without regard for results, the management of the World Bank has built a wall of misinformation around its lending operations, creating the illusion that all is well in the world of development. They have created the myth that

[27] Id., at p.50. Emphasis added.
[28] Id., at p.55.
[29] Smith, above n5, at p.236.

> they are at the "cutting edge" of development, while they hide the appalling number of failures within the Bank's portfolio – failures that enrich the governing elites of the Third World, while creating mountains of debt that cannot be repaid. Singing their own praises, they lead the Bank ever farther from its primary mission, ignoring their professional and fiduciary obligations as they advance their individual careers, while the people they have promised to help continue to live in poverty.[30]

Berkman believes that the Bank's critics who claim that $100 billion of the more than $500 billion the Bank loaned since its creation has disappeared through ill-conceived loans to dictators and corrupt governments is true. Lending to '*notoriously corrupt regimes in the Philippines, Zaire, Indonesia, Nigeria, and Haiti…paint a picture of an institution obsessed with lending, no matter to whom, and no matter with what results. World Bank loans were supposed to bring progress to the underdeveloped nations of the Third World, yet somehow the programs have never lived up to their promise. Instead, the poor remained mired in poverty while their governing elites amassed obscene fortune*.'[31]

Why were the World Bank and the American banks happy to lend money to corrupt regimes without due regard to security? According to Joel Kurtzman,

> Banks everywhere, flush with petrodollars, had to struggle to find big consumers to whom they could make big loans. Brazil, Mexico, Argentina, Nigeria, and others were wonderful customers, borrowing hundreds of billions worth of these "recycled petrodollars", as they were called… Just moving that money out the door was an achievement because the sums were so vast. Banks had to struggle to find clients. Never mind that at least $500-billion of those loans turned sour. Never mind that for a decade

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[30] Steve Berkman, 'The World Bank and the $100 Billion Question' in Hiatt (ed), above n13, at p.219.

[31] Id., at p.220. Emphasis added.

> the biggest borrowers did not make a single payment. Nor, in all likelihood, will they ever.[32]

Why were the American banks awash with petrodollars? The answer lies in political economy history. During the Arab-Israeli War of 1973, the U.S. provided $2.2 billion to Israel.[33] Saudi Arabia and other Arab oil producers retaliated by imposing a total embargo on oil shipments to the United States.[34] Consequently, the price of a barrel of crude oil rose dramatically from $1.80 in 1970 to $8.32 on 1 January 1974, slowly rising up to $39 in 1980, precipitating convulsions in international politics.[35] The oil embargo ended on 18 March 1974, but the trauma caused by those few months was immense since oil is the 'life-blood' of industrial economies. This forced the big corporations, international banks and the US government – the corporatocracy – to bond together as never before to ensure that oil supplies were protected and such interruptions never happened again.[36] The corporatocracy went to work to develop foreign policy changes designed to funnel petrodollars back to the U.S., U.K. and other industrialised centres of finance capital.[37]

The result was that, almost immediately after the embargo ended, the U.S. negotiated and concluded a series of agreements with Saudi Arabia, known as the U.S.-Saudi Arabian Joint Economic Commission (JECOR), to provide technical support and military

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[32] Joel Kurtzman, *The Death of Money* (1993) p.72. A 'petrodollar' is a U.S. dollar earned by a country through the sale of oil.

[33] Perkins, above n6, at p.83. On the war, see Daniel Yegin, *The Prize: The Epic Quest for Oil, Money & Power* (1991); Major Steven J. Piccirilli, *The 1973 Arab-Israeli War* (1989), online at http://www.globalsecurity.org/military/library/report/1989/PSJ.htm. <Accessed 18.06.08>.

[34] Perkins, ibid.

[35] David E. Spiro, *The Hidden Hand of American Hegemony: Petrodollar Recycling and International Markets* (1999) p.1.

[36] Perkins, above n6, at p.83.

[37] See details on this in William R. Clark, *Petrodollar Warfare* (2005).

assistance to the ruling royal House of Saud in exchange for accepting *only* U.S. dollars for its oil. Perkins, who was involved in this arrangement, elaborates:

> I understood, of course, that the primary objective here was not the usual – to burden this country with debts it could never repay – but rather to find ways that would assure that a large portion of petrodollars found their way back to the United States. In the process, Saudi Arabia would be drawn in, its economy would become intertwined with and dependent upon ours, and presumably it would grow more Westernized and therefore more sympathetic with and integrated into our system.[38]

Perkins points out that soon after, an OPEC agreement accepted the Saudi-U.S. arrangement and since then all oil has been traded in U.S. dollars. Hence the *oil standard* became the *dollar standard*.[39] Since oil is not only the most important commodity traded internationally, but also the key industrial mineral, international trade is conducted in U.S. dollar. Other countries must have sufficient U.S. dollar reserves to buy oil.

Under the JECOR arrangement, also secretly called SAMA (Saudi Arabian Money-laundering Affair, or Saudi Arabian Monetary Agency), Saudi Arabia would use its petrodollars to purchase U.S. government securities, and interests earned by these securities would be spent by the U.S. Treasury Department on U.S. companies developing infrastructure and providing goods and services to Saudi Arabia. 'The Saudis, rolling in cash, would deliver hundreds of millions of dollars to Treasury, which

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[38] Perkins, above n6 at p.85.

[39] See Stephen Schneider, *The Oil Price Revolution* (1983); Ian Seymour, *OPEC: Instrument of Change* (1980); David Holden and Richard Johns, *The House of Saud: The Rise and Rule of the Most Powerful Dynasty in the Arab World* (1981); Robert Baer, *Sleeping with the Devil: How Washington Sold Our Soul for Saudi Oil* (2003); See also information at http://english.pravda.ru/opinion/feedback/80382-petrodollar-0. <Accessed 18.06.08>;

held on to the funds until they were needed to pay vendors or employees. This system assured that the Saudi money would be recycled back into the American economy…'[40]

The U.S. dollar acting as global reserve currency in oil trade keeps the demand for the dollar "artificially" high. 'This enables the US to carry out printing dollars at the price of next to nothing to fund increased military spending and consumer spending on imports. There is no theoretical limit to the amount of dollars that can be printed. As long as the U.S. has no serious challengers and the other states have confidence in the U.S. dollar the system functions.'[41] In 2002, a former U.S. ambassador to Saudi Arabia reminded a committee of the U.S. Congress: '*One of the major things the Saudis have historically done, in part out of friendship with the US, is to insist that oil continues to be priced in dollars. Therefore the U.S. Treasury can print money and buy oil, which is an advantage no other country has*.'[42] Indeed, it is an advantage that compels oil and mineral rich developing countries to hold U.S. dollars in reserves instead of gold to their detriment because gold, which they have in abundance, is lost to purchase the dollar, which is earned through trade.

After entrenching Saudi Arabia into its economic system, the U.S. and the other OECD countries engaged in covert economic warfare with other developing countries during the oil price crisis.[43] One of the most devastating strategies was to increase the global money supply to cause inflation. As Arjun Makhijani explains:

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[40] Thomas W. Lippman, *Inside the Mirage: America's Fragile Partnership with Saudi Arabia* (2004) p.167.

[41] Online site, above n39.

[42] Ibid. Emphasis added.

[43] To understand financial and economic warfare, read Peter Gowan, *The Global Gamble: Washington's Faustian Bid for World Dominance* (1999); John Gray, *False Dawn* (1998); Robert A. Pastor (ed), *A*

> In the early 1970s, the United States and, to a varying extents, the other OECD countries, responded to OPEC's increases in oil prices by heavily expanding the money supply. The resulting inflation, together with the administered pricing policies in basic U.S. industries, sharply increased the prices of U.S. exports and thus the cost of many imports to the developing world. Such an inflationary policy enabled the OECD countries, as a group, to keep their current accounts in balance, despite the large oil prices… In effect, the United States largely insulated itself from the oil price hikes by passing the burden on to the developing world, whose current account deficits mounted. The developing world, in turn tried to ease this burden by borrowing heavily rather than by deflating.[44]

Inflation made imports very expensive and quickly depleted dollar reserves in developing countries, causing massive capital flight to the centre. In order to prop up their depleting foreign reserves, developing countries sought help from the IMF and the World Bank to provide short-term relief for the liquidity crisis they faced. The IMF and the Bank responded positively on the condition that these countries agreed to adopt *structural adjustment programs* (SAPs). With no alternatives, many Third World countries were compelled to accept these conditions.

According to Anup Shah, the SAPs were designed not to help but to trap the borrower countries in a debt trap – a major cause of Third World poverty today.[45] Susan George agrees, and reveals an interesting twist that about $418 billion in loan money flowed back to the banks of the developed world between 1982 and 1990.[46] This amount is more than

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Century's Journey: How the Great Powers Shape the World (1999); Anders Stephanson, *Kennan and the Art of Foreign Policy* (1989); David Mayers, *George Kennan and the Dilemmas of US Foreign Policy* (1988); John R. Commons, *Legal Foundations of Capitalism* (1995).

[44] Arjun Makhijani, *From Global Capitalism to Economic Justice* (1992) p.159.

[45] Anup Shah, *Structural Adjustment – A Major Cause of Poverty* - Global Issues - online at http://www.globalissues.org. <Accessed 04.02.09>.

[46] Susan George, *The Debt Boomerang* (1992) p.xiv-xvi; Howard M. Wachtel, 'The Global Funny Money Game' (26 December 1987) *The Nation* p.786; ---------, *The Politics of International Money* (1987) p.42; Fidel Castro, *Nothing Can Stop the Cause of History* (1986) p.68; Philip Agee, 'Tracking Covert Actions into the Future' (Fall 1992) *Covert Action Information Bulletin* p.6.

what was spent to rebuild Europe after World War II.[47] 'Capital flight from Mexico between 1979 and 1983 alone [was] $90-billion – an amount greater than the entire Mexican debt at that time.'[48]

> The big American banks…welcomed the money as savings, even though the lending officers in a different department had sent it to those same countries for supposedly productive uses… 40 percent of Mexico's borrowed money leaked away, 60 percent of Argentina's, and every penny of Venezuela's. Like alchemists, the Latin American elites converted the debt of the public at home into their private assets abroad… About one dollar out of every three loaned to Latin America by banks between 1979 and 1983 made that round trip.[49]

Some estimate that more than $70 billion was drained from Latin America to the U.S. and other OECD countries in 1986 alone.[50] The result is that poor people in the Third World service debts that never even reached their shores, let alone benefit them. And for money they never received, they have to live with SAPs that condemn them further into poverty. Just as 'Main Street' is paying 'Wall Street', to borrow the American jargon today, poor people are paying odious debts of the few rich ruling elites in the Third World.

C. Export Credit Agencies

Capital flight through debt service is also caused by export credit agencies (ECAs). ECAs are government financial corporations that provide government-backed loans, guarantees and insurance to their private domestic corporations seeking business investments in developing countries. 'Their mandate is to promote their own countries'

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47 Smith, above n5, at p.238.
48 Susan George, *Fate Worse Than Debt* (1990) pp.20, 236.
49 Lawrence Malkin, *The National Debt* (1988) pp.106-107; David Pauly, Rich Thomas and Judith Evans, 'The Dirty Little Debt Secret' (April 1989) *Newsweek* p.17.
50 Fidel Castro, *Nothing Can Stop the Cause of History* (1986) p.69.

exports and foreign investments.'[51] ECAs are organized as stock corporations under private law with the power to handle credit guarantees of their respective governments such as that of Germany[52] and France,[53] or they can be plain government agencies, established by legislation, such as the U.S. EX-IM Bank,[54] the British Export Credit Guarantee Department,[55] and the Australian Export Finance and Insurance Corporation (EFIC).[56]

Export Credit Agencies account '*for 80 percent of gross capital market financing in the world's seventy poorest countries; between 1997 and 2002 every private international commercial bank loan larger than $20 million to those countries was made with the backing of an official, industrialized country government ECA guarantee.*'[57] Many commentators generally agree that ECAs are collectively the single largest class of government finance that accounts for the single largest source of Third World debt.[58] Yet, ECAs are one of the most secretive organizations without any transparency and monitoring procedures.[59] For this reason, Aaron Goldzimer describes ECAs as '*worse than the World Bank*' and '*the secret engine of globalization*'.[60] Some of the secret and harmful conducts of ECAs include:

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[51] Centre for International Environmental Law (CIEL), *Export Credit Agencies and the World Trade Organization* available at http://www.ciel.org/Publications/ECAs_WTO_Nov03.pdf. <Accessed 09.06.08>.

[52] Euler Hermes Kreditversicherungs-AG.

[53] COFACE (Compagnie Francaise d'Assurance pour le Commerce Ext`ereiur).

[54] Established by the *Export-Import Bank Act* of 1945.

[55] Established by the 1991 *Export and Investment Guarantees Act*.

[56] Established by the *Export Finance and Insurance Corporations Act* 1991.

[57] Bruce Rich, 'Exporting Destruction' in Hiatt (ed), above n13, pp.273-303, at p.275. Emphasis added.

[58] See for example, Marijn Peperkamp, *European Export Credit Agencies and the Financing of Arms Trade* (Kantoor, Amsterdam: Dutch Campaign Against Arms Trade) online at http://www.stopwapenhandel.org/projecten/Exportkrediet/EKVartikelen/ECAs06.pdf. <Accessed 09.06.08>.

[59] CIEL, above n51.

[60] Aaron Goldzimer, *Worse Than the World Bank? Export Credit Agencies: The Secret Engine of Globalization* (Food First Backgrounder, Winter 2003) online at http://www.thirdworldtraveler.com. <Accessed 09.06.08>. Emphasis added.

- Support for destructive projects that even the World Bank will not touch;[61]
- Lack basic environmental, human rights, corruption, and other safeguards;[62]
- Undercut their governments' own development and environmental policies and multilateral agreements;[63]
- Contribute heavily to developing countries' debt burdens;[64]
- Have little or no transparency or accountability;
- Provide corporate welfare by passing the business' risks and losses on to the unwitting taxpayers;[65]
- Contribute significantly to arms trade, the expansion of nuclear power, and global warming;[66] and
- Low-risk financing for high-risk projects.[67]

While global civil societies have succeeded in generating public debate about previously anonymous institutions like the World Bank, the World Trade Organization (WTO) and the IMF, ECAs have remained obscure from public scrutiny until fairly recently. Many

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[61] The Three Gorges dam project in China, which is nearly half the length of California, in a watershed that is home to more than 370 million people, that is likely to deposit industrial waste and 530 million tons of silt annually, which the World Bank refused to fund, but ECAs have provided $1.5 billion of the total cost of $43 billion, is an example. See Lori Udall, 'Export Credit Agencies', one of the 126 contributing papers to the World Commission on Dams, prepared for *Thematic Review V.4: Regulation, Compliance and Implementation Options*, available at http://www.dams.org/docs/kbase/contrib/ins207.pdf. <Accessed 09.06.08>.

[62] See Udall, ibid.

[63] Dan Ikenson, 'Steel Trap: How Subsidies and Protectionism Weaken the U.S. Steel Industry' (Trading Brief Paper No. 14, Cato Institute, Washington D.C., 1 March 2002); Mark A. Groombridge, 'America's Bittersweet Sugar Policy' (Trading Briefing Paper No.13, Cato Institute, Washington D.C., 4 December 2001).

[64] ECA-backed loans carry higher interest rates than most of the World Bank or the IMF or other financial loans. 'Roughly 64 percent of Nigeria's entire external debt is for export credits; for the Democratic Republic of Congo, it's 42 percent: see Goldzimer, above n60.

[65] See Stephen Slivinski, 'The Corporate Welfare Budget Bigger than Ever' (10 October, 2001) No.415 *Policy Analysis*, available online at http://www.cato.org/pubs/pas/pa415.pdf. <Accessed 10.06.08>;

[66] See European Network Against Arms Trade (ENAAT), *European Export Credit Agencies and the Financing of Arms Trade* (Kantoor, Amsterdam: ENAAT, available online at http://www.vredesmuseum.nl/download/european_export.pdf. <Accessed 09.06.08>. See also Peperkamp, above n58.

[67] Goldzimer, above n60.

civil society groups today criticise ECAs as being 'full of corruption, collusion and nepotism' causing capital flight, environmental devastation and social dislocation in developing countries.[68] They argue that since ECAs use taxpayer money to make it cheaper and less risky for domestic private corporations to export or invest overseas, they must become transparent and accountable. 'Like department stores that provide credit so people without cash will buy the store's products, rich countries (through their ECAs) provide loans and credits to developing countries so that they will buy the rich country's exports. The results include debt for the poor countries and increased sales and foreign investment opportunities for multinational corporations based in wealthy countries.'[69] Accordingly, ECAs have become not '*only by far the single largest part of public financial flows from North to South, but they are also the least examined, the least transparent, the least accountable, and in some ways, the most harmful*.'[70] Among others, ECAs are harmful in two critical ways: first, as bilateral agencies pursuing national interests, ECAs can turn private commercial loan into a public debt; and secondly, ECAs can cause budgetary liabilities for developing countries by hiding ECA loans from the country's debt statistics.

In the first case, for instance, if an Australian exporter or bank seeks an export credit from Export Finance and Insurance Corporation of Australia (EFIC), the Australian bank or exporter's risks shifts to the EFIC as an ECA, and becomes a public risk. Now, if the EFIC-backed loan was made to a private company in PNG, Australia would insist that the PNG government provide a counter-guarantee. If the private company in PNG does not

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[68] In the case of Indonesia, for example, see Stephanie Fried of the Environmental Defence and Titi Soentoro of Bioforum, 'Export Credit Agency Finance in Indonesia' (Jakarta: December 2000), copy online at http://www.boell-southeastasia.org/download_en/ECA_Finance_in__Indonesia.pdf. <Accessed 09.06.08>.

[69] Goldzimer, above n60.

[70] Ibid. Emphasis added.

pay for the imported goods, or fail to repay the loan it secured from the Australian private bank, they will become a PNG government debt to be paid by PNG taxpayers. Meanwhile, the Australian exporter or bank can claim from the EFIC. The EFIC will, through the Australian government, recover its costs from the PNG government. It is assumed that the PNG government will recover its costs from the PNG company. The U.S. company Enron's Dabhol Power Project case in India ably demonstrates this point.[71] The Dabhol case shows that powerful countries can exert enormous pressure, even with the threat of economic sanctions and military intervention, to extract money from taxpayers in the poor developing countries to finance their rich companies who make risky investments.

The second aspect about ECAs (budgetary liabilities) is also demonstrated by the Dabhol case. Because of perceived risks involved in investment, governments of developing countries also provide additional guarantees in addition to the counter-guarantee. For instance, in the Dabhol case, the Maharashtra state government entered into power purchase agreement (PPA) with Enron at a high, dollar-dominated price.[72] When the Indian state government refused to honor its purchase agreement, Enron estimated the size of its legal claim against the government of India to be around $4 to $5 billion.[73] Since a purchase agreement is not a loan, this amount was never indicated as debt to the Indian government, even though it had multi-million dollar budgetary implications. The

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[71] For details on this see Minority Staff Committee on Government Reform, U.S. House of Representatives, 'Fact Sheet: Background on the Enron's Dabhol Power Project' (22 February 2002), available online at http://oversight.house.gov/documents/20040830150742-77212.pdf. <Accessed 10.06.08>. See also Marcus Chadwick, *The Overseas Private Investment Corporation: Political Risk Insurance, Property Rights and State Sovereignty*, a Ph.D Thesis submitted to the University of Sydney (University of Sydney: Faculty of Economics and Business, 2006) ch.4.

[72] Similar purchase agreement for the purchase of locally refined petroleum products has been entered between the PNG government and the Canadian oil company InterOil, which set up PNG's first oil refinery project near Port Moresby. The PNG loan agreements can be located at http://www.secinfo.com/dsvRu.u1Ne.6.htm. <Accessed 10.06.08>.

[73] Goldzimer, above n26.

Dabhol case demonstrates how foreign investors are protected and supported by their home governments to affect neocolonialism causing underdevelopment.

The Australian-based NGO *AidWatch* provides some interesting statistics of ECAs backed by the Australian EFIC in PNG's natural resources sector as shown in Table 8.1 below.[74]

Table 8.1. EFIC – the Australian ECA in PNG.

Project	Year	Facility	Borrower	Exporter	Details of Project
Bougainville Copper Mine	1978	$4.2 million loan	Bougainville Copper Ltd	Vickers Australia Ltd	Bougainville Copper Mine
Ok Tedi Mine	1982	Loan (Line of Credit $212 million)	Ok Tedi Mining Ltd	Multiple Exporters (Line of Credit)	Various, for mining projects
Ok Tedi Mine	1983	Loan $12 million	The North Fly Highway Dev. Corp.	Multiple Exporters (Line of Credit)	Road construction for the Ok Tedi project
Porgera Gold Mine	1990	Loan $52.7 million	MRDC P/L	Multiple Exporters (Line of Credit)	
Porgera	1991	Loan $159.9 million	Highland Gold Properties P/L	Various (Line of Credit)	Construction of gold mine
Kutubu Oil Project	1992	Loan $326.5 million	Ampolex (PNG Petroleum Inc.,) Oil Search Kutubu P/L	Multiple exporters	various
Not Specified		1995	Insurance – type not specified		The mining investment totaled $28 m.
Lihir Mine	1995/ 96	Political risk insurance			Lihir Mine

Source: www.aidwatch.org.au

[74] AidWatch identifies the functions of the EFIC as being (1) to provide loan to Australian companies doing business in PNG; (2) provide general insurance; and (3) to provide political risk insurance. The U.S. Overseas Private Investment Corporation (OPIC), and the Japan Ministry of International Trade and Investment Insurance Department (MITI) perform similar functions.

PNG may be resource-rich but such statistics reveal that those resources have been, and continue to be exploited for the benefit of foreign owners of finance capital. Indeed this is so because apart from the 22.5 percent equity the PNG government elects to reserve for itself in oil and gas projects, and 30 percent in mining projects, all the rest of the shares are held by foreign owners of capital. Apart from the environmentally controversial Ok Tedi copper mining project, even the minor interests the PNG government elected to take up in all existing mineral and oil projects have been privatised and bought of by foreigners by 2003.

The operations of ECAs indeed expose the hypocritical policy stance of the developed countries. Transparency, good governance, environmental protection, removal of government interference in the operations of the free market, free trade, privatisation, and all other policies prescribed to developing countries do not apply to the operations of their ECAs. As Rich observes:

> The net result is an enormous – and obscene – policy joke at the expense of the world's poor. … The rich countries preach free markets and increased transparency in governance to developing nations. In contrast, their ECAs work surreptitiously to subsidize trade at home, their most important transactions are excluded from the requirements of the World Trade Organization, and they use the pretext of commercial confidentiality to remain opaque themselves – most refuse to release even the most basic information about what they do.[75]

D. Foreign Aid

Foreign aid performs similar functions as the ECAs. Since foreign aid loans are tied to purchases from creditor nations, on paper they are recorded as being given to a

[75] Rich, above n57.

developing country, but in reality, most of the money is withheld to pay selected corporations supplying the commodities to the aid recipient developing country. As the Sydney-based *AidWatch* comments regarding Australian aid:

> While it is a common conception that aid is a tool for benevolence and altruism, the Australian government has continued to subsidise Australian business and promote our own "national interest" over the interests of recipient countries through our aid program. Over 40% of Australian aid is officially "tied". This translates to Australian taxpayers supporting Australian business and delivering aid that institutions such as the World Bank estimate to be 20-25% more costly than untied aid. Unofficially, AusAID staff have stated off the record that up to 90% of Australian aid money boomerangs back to Australia.[76]

Apart from support for Australian businesses, one of the ways in which Australian aid boomerangs back to Australia is through the employment of expensive consultants. As AidWatch observes: '*What Australian aid money has done in PNG is to produce a band of Australian consultants and businesses that make huge dollars from the delivery of aid.*'[77] For instance, most of the $60 million budgeted for HIV/AIDS projects in 2003 has been used up in wages and costs of foreign staff who comprised 222 of the 264 employed. Table 8.2 below shows the main recipients of Australian aid contracts in PNG in 2003/2004.

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[76] AidWatch, *Australian aid to PNG: The Boomerang effect continues: Part II* (February 2005), available online at http://www.aidwatch.org.au/assets/aw00681/PNG%20Feb%2028%20final.pdf. <Accessed 19.06.08>. See also Tim O'Connor and Kate Wheen, *Australian Aid: Separating the Wheat from the Chaff* (15 March 2006) Green Left Online, at http://www.greenleft.org.au/2006/660/7191. <Accessed 19.06.08>.

[77] Ibid. Emphasis added.

Table 8.2

Rank	Contractors	Total No. of Contracts	Value of Contracts in $ millions
1	ACIL Aust. Pty Ltd	7	136.62
2	IDP Education Australia Ltd	3	133.66
3	SAGRIC International Pty Ltd	7	83.94
4	AusAID PNG Roads	2	60.37
5	GRM International	3	47.88
6	IDSS	1	42.48
	Total of Top 6	**23**	**504.95**
	Total of AusAID in PNG	**142**	**771.87**
	% Top 6 in PNG/AusAID	**16.2%**	**65.42%**

Source: *AidWatch*:

In this manner, the $15 billion Australian aid provided since independence in 1975 has boomeranged to Australia without leaving any significant impact of this money in PNG. Other OECD countries follow the same boomerang aid policy as Australia. For instance, over 80 percent of America's foreign aid returns immediately through exports tied to that aid.[78] '*In fact, aid money typically never leaves the donor country; it is credited to other institutions in the donor country to which money is owed.*'[79] For instance, commenting on Japanese aid, the Prime Minister of Malaysia pointed out that, 'Although Japan furnishes loans, it takes back with its other hand, as if by magic, almost twice the amount it provides'."[80]

Yet, in the name of aid, which hardly benefits the recipient country, donor countries benefit not only by providing subsidies and carving out market niches for their corporations, but also influencing development policies in developing countries. For this reason, this thesis views foreign aid as an instrument of neocolonialism, just as export credit agencies are.

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[78] See Dan Nadudere, *The Political Economy of Imperialism* (1977); Michael Moffitt, 'Shocks, Deadlocks and Scorched Earth: Reaganomics and the Decline of U.S. Hegemony,' 4 (Fall 1987) *World Policy Journal* p.576.

[79] Smith, above n5, at p.238. Emphasis added.

[80] Quoted in Smith, ibid.

II. MONEY LAUNDERING AND TAX EVASION

Capital flight is also caused by foreign corporations and corrupt political leaders of developing countries who launder money and avoid their domestic tax obligations by hiding money in offshore accounts depriving developing countries of taxable revenue.[81] The RCT treats corruption by local political elites as a more serious problem than capital flight through tax evasion by private corporations. However, according to the *European Network on Debt and Development* (EURODAD), the converse is true. 'Corruption related illicit flows account for only 5% and criminal related account for around 30% while commercial illicit flows, driven by tax avoidance schemes account for more than 60% of the problem.'[82]

In another report dated 24 October 2008, ERUODAD notes that every year '*developing countries lose at least €117 billion of tax revenues due to aggressive tax avoidance and tax evasion. Between €256 and €366 billion fly illicitly out of developing countries for commercial reasons related to tax avoidance and evasion, linked to the abuse of mechanisms such as transfer pricing or mispricing by transnational corporations. These flows are several times higher than official aid or foreign direct investment. They constitute an outrageous "reverse welfare", with money being transferred from the poorest countries to the richest and the tax havens*.'[83] EURODAD believes that *transfer*

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[81] For a comprehensive treatment on tax evasion, see David F. Burg, *A World History of Tax Rebellions* (2004). For a specific example, see Lucy Komisar of the Tax Justice Network, *Citigroup: A Culture and History of Tax Evasion* available online at http://www.taxjustice.net/cms/upload/pdf/Citigroup_-_a_culture_and_history_of_tax_evasion.pdf. <Accessed 04.01.09>. For tax evasion in developing countries, see Gerald A. Epstein ed., *Capital Flight and Capital Controls in Developing Countries* (2005). Tax evasion is also a problem in developed countries but here we are concerned with developing countries only.

[82] European Network on Debt and Development, *Removing Harmful Practices and Increasing Regulating* online at http://www.eurodad.org/debt/?id=2194. <Accessed 04.01.09>.

[83] European Network on Debt and Development, *A European Agenda to Fight Capital Flight* (24 October 2008) online at http://www.eurodad.org/debt/report.aspx?id=2196&item=3028. <Accessed 04.01.09>. Emphasis added.

pricing is one of the most common and effective form of tax avoidance adopted by transnational companies. In their words:

> This happens first by creating subsidiary companies in tax havens and then by transfer mispricing practices within them. Transfer mispricing is a common practice by which TNCs sell goods or services to subsidiary companies registered in other jurisdictions at artificially high or low prices in order to minimise taxes paid. As a result, transnational companies escape to their duty of paying taxes, not only preventing developing countries from national resources but also provoking an unfair competition with smaller domestic companies which are unable to compete with big transnational corporations. This represents a huge leak of money since it is estimated that 60% of global exchanges happen within subsidiary companies of the same transnational corporation. As a result, Southern states become more dependent on donors-creditors and domestic markets are seriously damaged.[84]

A July 2008 investigative report by Greenpeace International entitled *Conning the Congo* reveals how a Switzerland-based German logging company, the Danzer Group, has been exporting timber products at below world market price to shift profits out of the Democratic Republic of Congo (DRC) and the Republic of Congo to its offshore subsidiary, Interholco.[85] Greenpeace observes that:

> Internal Danzer Group documents show in great detail the price fixing arrangements between the Group's Swiss-based trading arm Interholco AG and the parent firm's logging subsidiaries in the DRC and the Republic of the Congo. The DRC-based Siforco sells its wood to Interholco at an official price below the true market value of the wood. The shortfall is made up through unofficial payments into offshore bank accounts in

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[84] EURODAD, above n82.

[85] Greenpeace International, *Conning the Congo* (Greenpeace International, Amsterdam, July 2008), online at http://www.greenpeace.org/raw/content/international/press/reports/conning-the-congo.pdf. <Accessed 04.02.09>. See also Tax Justice Network, *Conning the Congo: $15 Billion in Capital Flight* available at http://taxjustice.blogspot.com/2008/07/conning-congo-15-billion-in-capital.html. <Accessed 04.01.09>.

> Europe, enabling the Danzer Group to evade the payment of a variety of taxes to which it is liable in the DRC.[86]

A report from the Washington-based *Global Financial Integrity* estimates that the DRC lost an estimated $15.5 billion due to capital flight from 1980 to 2006. Pervasive corruption and trade mispricing in goods and services caused the loss of almost $600 million per annum, but had it been prevented, the DRC could have paid off its entire external debt, which is $11.2 billion, and the remaining US$4.3 billion would have been left to add to the country's foreign exchange reserves or used to invest in infrastructure and human capital.[87] Sadly, such transfer mispricing practices take place not on the free market but in transactions between subsidiaries of the same corporate parent, so it is difficult for governments of poor countries to regulate and monitor it.[88]

An April 2008 study by Leonce Ndikumana and James K. Boyce of the Political Economy Research Institute at the University of Massachusetts, Amherst, reveals that between 1970 and 2004, capital flight over the 35-year period from Sub-Saharan Africa's least developing countries totaled US$420 billion.[89] Of three general reasons provided, the study finds that the region's external indebtedness is the most important cause of capital flight.[90]

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[86] Greenpeace International, ibid.

[87] Global Financial Integrity, *Illicit Financial Flows from Developing Countries* online at http://www.gfip.org/storage/gfip/executive%20-%20final%20version%201-5-09.pdf. <Accessed 04.02.09>.

[88] Bruno Gurtner, chair of the international board of *Tax Justice Network* made this observation at the launching of the Greenpeace report *Conning the Congo* on 30 June 2008 in Zurich, reported in Tax Justice Network, above n85.

[89] Leonce Ndikumana and James K. Boyce, 'New Estimates of Capital Flight From Sub-Saharan African Countries: Linkages with External Borrowings and Policy Options' (Working Paper Series No.166, (Massachusetts University, Amherst, MA, 24 April 2008).

[90] Id., at p.3. That study was an expansion of their previous work published in Gerald A. Epstein (ed), above n81.

According to a 2005 study by the *Tax Justice Network*, about $11.5 trillion *high-net-worth* assets were offshore, tax-free or minimally taxed.[91] 'If income from these assets were taxed at an average rate of 30 percent, government revenue would increase by $255 billion annually, sufficient to allow major tax cuts for the less-well-off or to finance the entire United Nations Millennium Project, which aims to halve world poverty within a decade. The current global aid budget of $78 billion pales to insignificance along this estimate of revenue loss, which does not include the additional losses caused by corporate tax dodging – in all its forms – or the harmful impact on developing countries of tax competition…'[92]

In some developing countries, oppressive rulers and corporate elites use offshore accounts to finance resource wars and to buy arms. According to an October 2007 estimate by some civil society groups, about $18 billion per year is lost by Africa alone in buying weapons from the industrialised countries.[93] Paul Collier estimates that illicit money sent out of the region by corrupt rulers is about $20 to $28 billion per year.[94] This is made possible by financial companies in tax havens which 'help launder black earnings.'[95] According to Andrew Pendleton of *Christian Aid*, of the 72 world tax havens, 35 are controlled by British corporatocracy. Since corrupt politicians use the secrecy laws of the tax haven countries to launder money, any debate on poverty

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91 Tax Justice Network, 'The Price of Offshore' (Tax Justice Network, London, March 2005). High-net-worth is explained below.

92 John Christensen, 'Dirty Money: Inside the Secret World of Offshore Banking', in Hiatt (ed), above n13, at pp.59-96.

93 IANSA (the International Network on Small Arms), Oxfam International and Safeworld, 'Africa's Missing Billions: International Arms Flows and the Cost of Conflict', (Briefing Paper 107, October 2007). Copy is available at http://www.oxfam.org. <Accessed 27.06.08>.

94 Paul Collier, 'A Chance to Crack-Down on Africa's Loot-Seeking Elites', *The Guardian* (Tuesday 7 October 2008) online at http://www.guardian.co.uk/commentisfree/2008/oct/07/banking.regulation.africa. <Accessed 04.02.09>.

95 Girish Mishra, *Financialization in Globalized World* (24 August 2007) posted at http://www.zmag.org/znet/viewArticlePrint/14648. <Accessed 16.06.08>.

reduction would be useless without putting plugs to the sources of financial leaks from the periphery to the centre.[96]

John Christensen who corroborates Perkins' confessions worked in an offshore (tax haven) banking industry for some years and provides some useful detail on this very secretive and exclusive industry.[97] First, he points out that tax havens have increased from 25 in the early 1970s to 72 by the end of 2005 as a consequence of financial liberalization. The offshore industry manages a staggering $30 trillion worth of client assets globally.[98] Most of the tax havens are closely linked to the 'big three' global financial centres of London, New York and Tokyo.[99] The 'offshore banking lies at the core of a globalized financial system that enables businesses and the superrich, known within banking circles as *high-net-worth* individuals…to operate beyond the reach of onshore public or legal authority.'[100] The significance and economic consequence of offshore banking is exemplified by the case of Latin America. According to Christensen, Latin American wealth is highly concentrated, with about 300,000 people holding about $3.7 trillion of personal assets. Over 50 percent of the total holdings of cash and listed securities are held offshore, consequently causing a retarded growth in the region leading to a vicious cycle of 'underinvestment, unemployment, and social exclusion, fueling poverty, crime and extremism.'[101] This indeed provides an interesting contrast to the causes and explanations the RCT offers.

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[96] Conal Walsh, 'British Tax Havens Help Cheat Third World Out of Billions' *The Guardian* (Sunday 18 September 2005) online at http://www.guardian.co.uk/business/2005/sep/18/tax.internationalaidanddevelopment. <Accessed 30.06.08>.

[97] Christensen, above n92., at pp.79-80.

[98] Id., at p.79.

[99] Id., p.78.

[100] Ibid. Emphasis added.

[101] Id., at p.79.

III. CAPITAL FLIGHT UNDER NEOLIBERALISM

The forgoing *traditional* forms of capital flight have been exacerbated by the globalization of neoliberalism, or simply put, *neoliberalization*.[102] Three aspects of *neoliberalization* of interest here are *privatisation*, *financial liberalization* and *trade liberalization*. These 'unholy *ti-lization* trinity' have done more harm than good to the development trajectories of developing countries. Let us take a closer look at each of these causes of capital flight.

A. Privatisation

Privatisation, which takes place in various forms,[103] is the 'transfer of ownership, control, functions and/or services from the public sector of the economy to the private sector.'[104] Neoliberal argument for privatisation is that it brings increased *efficiency*[105] 'by (i) transferring the production of goods and services from the less efficient public sector to the more efficient private sector, (ii) allowing the private sector to compete in areas previously restricted to the public sector (and thereby applying pressure on the public sector to improve performance) or, (iii) introducing the threat of potential competition from the private sector.'[106]

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102 See Mark Hamilton Purcell, *Recapturing Democracy: Neoliberalization and the Struggle for Alternative Urban Futures* (2008).

103 On the various forms of privatization (at least 22 forms), see M. Pirie, *Privatisation: The British Experience and its Application to Australia* (1985). See also C. Vuysteke, 'Techniques of Privatisation of State-Owned Enterprises, Volume 1,' (World Bank Technical Paper No. 88, Washington D.C., 1988).

104 B. Mansfield, 'The Public Sector: Efficiency and Equity' in P. Abelson (ed), *Privatisation: An Australian Perspective (*1987) p.71.

105 On the theory of efficiency, see Brian E. Dollery and Joe L. Wallis, 'Economic Efficiency' in Jack Rabin and T. Aaron Wachhaus (eds), *Encyclopedia of Public Administration and Public Policy*, (2008).

106 O. Chin and G. Webb, 'Privatisation: A View from the Private Sector' in Abelson (ed), above n104 at p.27.

But this thesis argues that in the name of *efficiency* (which has not eventuated) not only *equity* is sacrificed but also the *means of production* from public ownership is transferred to private monopoly capitalists.[107] Instead of recommending policies to make the *public means of production* to be efficient, for instance, by strengthening the rule of law to prevent corruption and abuse, or instill transparency and sound management practices, the resource curse theorists recommend transfer of the 'goose that lays the golden eggs' that benefit the public to private ownership.

According to David Harvey, such a privatisation policy amounts to *acquisition by dispossession*, and a new form of *enclosure of the commons* that has been fine-tuned to play a stronger role now than in the past.[108] As he puts it: '*Since privatization and liberalization of the market was the mantra of neo-liberal movement, the effect was to make a new round of 'enclosure of the commons' into an objective of state policies. Assets held by the state or in common were released into the market where overaccumulating capital could invest in them, upgrade them and speculate in them.*'[109]

Privatisation experiences in PNG show that guaranteed and sustainable sources of public revenue are transferred forever into private hands, making the government dependent on foreign aid, loans and natural resources revenue. Before the onslaught of privatisation the IMF and World Bank forced upon PNG since 1991, government-owned corporations paid good annual dividends to the PNG state. For instance, the Electricity Commission, Post & Telecommunication Corporation, Air Niugini and Harbours Board contributed to

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[107] See David Rothkopf, *Superclass: The Global Power Elite and the World They Are Making* (2008).
[108] David Harvey, *The New Imperialism* (2003).
[109] Id., at p.158. Emphasis added.

the government revenue K24.3 million in 1990, and K14.3 million in 1991.[110] After privatisation, these sources of state annual revenues have been ended permanently. Enviable assets and entities like the former Papua New Guinea Banking Corporation (PNGBC) and Orogen Minerals Limited, a national oil and mining company, have gone forever to foreigners.[111] So, privatisation in reality is, according to J.W. Smith, a form of *financial warfare* waged by corporate imperialism. In his words:

> The funds to purchase industries, when weak nations are forced to privatize publicly-owned businesses, are primarily in the developed world. Thus, the same powerful people who impose these harsh conditions upon the weak are the ones who buy up their resources and industries at a fraction of true value when those harsh conditions trigger a collapse. Not only does privatizing the world's industries and resources under corporate imperialism provide opportunities for the investment of subtly-monopolized capital and control of industries, resources, and markets, but a portion of that monopolized capital…owned by the emerging "robber barons" of the dependent nations give the appearance of equality and makes it difficult to identify and target a nation, or block of nations, as an enemy imposing the harsh conditions of financial warfare.[112]

Indeed, not only natural resources but also wealth-producing public assets and service industries are sold to foreign private corporations who import goods from their parent companies cheaply and sell them at inflated prices. In this manner, the 'petrodollar cycle' from privatisation to transfer pricing is complete. Underdevelopment is the undeniable and natural consequence.

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[110] These figures were then equivalent to US dollar before the Kina was floated in 1994, which brought the value down. Lawrence Kuna-Kalinoe, 'Corporatisation and Privatisation of State-Owned Enterprises in Papua New Guinea: A Review of the Policy and Process,' a paper made available to me by the author, at p.19.

[111] The Morauta government in 2001 sold PNGBC to Bank South Pacific (BSP) and Orogen to Oil Search Limited.

[112] Smith, above n5, at pp.202-03.

B. Financial Liberalization

While privatisation transfers public assets into private ownership, financial liberalization is a major lever of predation, fraud and thievery through financial destabilization, devaluation and inflation, credit and stock manipulation, raiding of pension funds, dispossession of assets, and manipulation of prices of strategic resources.[113] Financial liberalization removes fixed exchange regimes and imposes floating regimes. This measure causes depreciation and destabilization of currencies and ultimately inflation.[114] Financial destabilization and inflation in turn not only cause capital flight, but also cause the transfer of public ownership of assets into new private owners. The Asian financial crisis of 1997 and the economic meltdown of Argentina in 2001 provide useful examples.[115] As some observers comment:

> Financial crisis have always caused transfers of ownership and power to those who keep their own assets intact and who are in the position to create credit, and the Asian crisis is not exception…there is no doubt that Western and Japanese corporations are the big winners. '…The combinations of massive devaluations, IMF-pushed financial liberalization and IMF-facilitated recovery may even precipitate the biggest peacetime transfer of assets from domestic to foreign owners in the past fifty years anywhere in the world, dwarfing the transfers from domestic to US owners in Latin America in the 1980s or in Mexico after 1994. One recalls the statement attributed to Andrew Mellon: 'In a depression, assets return to their rightful owners.'[116]

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113 Harvey, above n108., at p.147.

114 See Puru Saxena, *The Inflation Mystery* (15 August 2005) online at http://www.321gold.com/editorials/saxena/saxena081505..html. See also Hon. Ron Paul of Texas in the House of Representative, *Conspiracies, Cover-Ups, Truths, Facts, Oddities, Research* (5 September 2005) online at http://www.illuminati-news.com/papermoney-and-tyranny.htm. <Both accessed 30.06.08>.

115 Yilmaz Akyuz, 'Causes and Sources of the Asian Financial Crisis' (Paper presented at the Host Country Event: Symposium on Economic and Financial Recovery in Asia, United Nations Conference on Trade and Development X, 17 February 2000); Juzhong Zhuang and J. Malcolm Dowling, 'Causes of the 1997 Financial Crisis: What Can an Early Warning System Tell Us?' (ERD Working Paper Series No. 26, Asian Development Bank, Manila, October 2006).

116 Wade and Veneroso, quoted by Harvey, above n108., at pp.150-51.

Financial liberalization causes herd-like behaviour of financial speculators to move money quickly into and out of a country causing boom-bust financial cycles. In the case of Asia, what began as a rumour among financial speculators from the North who provided short-term loans to Thailand's booming real estate industry in the 1990s called back their investments upon hearing that Thailand did not have enough U.S. dollars to back up its currency. The panic quickly spread to other Asian 'tiger' economie*s*. To restore confidence, Asian governments were forced to drain their reserve banks in an effort to prop up their currencies. This, however, turned the original fear into a reality. 'The market responded with more panic. In one year, $600 billion had disappeared from the stock markets of Asia – wealth that had taken decades to build. … Korea was losing $1 billion a day and its debt was downgraded to junk bond status.'[117] Investors poured $100 billion into South Korea in 1996 but the following year they took them out and left Korea with a negative investment of $20 billion – a discrepancy of $120 billion.[118]

The IMF went in with its economic medicine – the SAPs – which exacerbated the problem by transferring billions of dollars worth of public assets the Asians sweated for decades to build, at very cheap prices to the same financial herders who caused the crisis.[119] Thailand cried: 'We have lost our autonomy, our ability to determine our macroeconomic policy…'[120] The Koreans called it a 'National Humiliation Day', referring to the day the IMF loan agreement was signed.[121] Indeed, it was a time of regional humiliation because public assets were stripped away and transferred to private

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[117] Naomi Klein, *The Shock Doctrine: The Rise of Disaster Capitalism* (2007) p.265 & 272.

[118] Irma Adelman, 'Lessons from Korea', in Lawrence R. Klein and Marshall Pomer (eds), *The New Russia: Transition Gone Awry* (2001) p.129.

[119] See Klein, above n117, ch.13 for the list of companies sold.

[120] Supachai Panitchpakdi (Thailand's Deputy Premier) quoted in Nicola Bullard, 'Taming the Tigers: The IMF and the Asian Crisis' (Focus on the Global South, London, 2 March 1999), quoted by Klein, id, at p.270.

[121] Michael Lewis, 'The World's Biggest Going-Out-of-Business Sales,' *New York Times Magazine*, 31 May 1998, quoted in Klein, ibid.

corporations, and thousands of jobs were shed, plunging most people of the region into poverty.[122] It was a form of *economic genocide*, carried out through the conscious and deliberate manipulation of market forces.[123] 'When compared to previous periods of colonial history (e.g. forced labour and slavery), the social impact of structural adjustment program is devastating… it affects directly the livelihood of more than four billion people.'[124]

C. Trade Liberalization

Forcing developing countries to remove import duties, tariffs and infant industry protection under the banner of trade liberalization, while maintaining the same in the developed countries, is yet another form of 'economic warfare'. '*Tariff peaks and quotas deprive LDCs [least developing countries] approximately US$2.5 bn per annum...in export revenues. ... The US and Canada are the worst offenders, each depriving LDCs of more than US$1bn in export earnings. For every US$1 that the USA provides to Bangladesh in aid, it confiscates another US$7 through restrictive trade practices.*'[125] Trade rules imposed by developed countries through trade treaties provide some of the harshest conditions to prevent developing countries from pursuing policies that can make them develop and escape from poverty. As a March 2007 Oxfam study claims:

> The quiet advance of trade and investment agreements between rich and poor countries threatens to deny developing countries a favourable foothold in the global economy. … Rich countries are using…bilateral and regional 'free trade agreements'…and investment treaties to win concessions that they are unable to obtain at the World Trade Organization…where developing countries can band together and hold out more

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[122] Klein, id., at p.272, provides statistics on job losses and unemployment caused by the crisis.
[123] Harvey, above n108.
[124] Michel Chossudovsky, *The Globalization of Poverty and the New World Order* (2003) p.20.
[125] Oxfam International, 'Rigged Trade and Not Much Aid: How Rich Countries Help to Keep the Least Developing Countries Poor' (Oxfam, Washington D.C., May 2001) p.3. Emphasis added.

> favourable rules. … The worst of the agreements strip developing countries of the capacity to effectively govern their economies and to protect their poorest people. Going beyond the provisions negotiated at a multilateral level, they impose far-reaching, hard-to-reverse rules that systematically dismantle national policies designed to promote development.[126]

The developed countries provide about $257 billion annually through subsidies and import duties to their wealthy landowners and agro-corporations to encourage production for export to compete with commodities produced by poor farmers in the periphery.[127] Rich industrial countries provide subsidies to many other industries too.[128] In the case of the United States, for instance, part of its military budget is a disguised form of government subsidy to its private corporations providing military hardware. For instance, the three top recipients of government funds from 2002 to 2007 were:[129]

Table 8.3

Year	*Lockheed Martin*	*Boeing*	*Northrop Grumman*
2002	$17 billion	$16.6 billion	$8.7 billion
2003	$21.9 billion	$17.3 billion	$11.1 billion
2004	$20.7 billion	$17.1 billion	$11.9 billion
2005	$19.4 billion	$18.3 billion	$13.5 billion
2006	$26.6 billion	$20.3 billion	$16.6 billion
2007	$27.8 billion	$22.5 billion	$14.6 billion

[126] Oxfam International, 'Signing Away the Future: How Trade and Investment Agreements Between Rich and Poor Countries Undermine Development' (Oxfam Brief Paper 101, Washington D.C., 20 March 2007) p.2.

[127] Oxfam International, 'A Round for Free Trade: How Rich Countries are Getting a Free Ride on Agricultural Subsidies at WTO' (Oxfam Briefing Paper 76, Washington D.C., 15 June 2005) p.6.

[128] For instance, the US government provided over $1 billion in subsidies to Wal-Mart Stores Inc., the world's largest retail operator, which made about $9 billion profit in 2003. The millions provided to this company are enumerated by Philip Matera and Anna Purington with Jeff McCourt, Doug Hoffer, Stephanie Greenwood & Alyssa Talanker in 'Shopping for Subsidies: How Wal-Mart Uses Taxpayer Money to Finance Its Never-Ending Growth' (Good Jobs First, Washington D.C., May 2004). In June 2008, for example, the Rudd Government provided $70 million to the giant car-maker Toyota to build a hybrid version of its Camry sedan in Australia. Toyota admitted that it would have gone ahead without the subsidy, meaning, it did not need it, although it is 'always nice to have support'. See *The Australian,* 'Labours $70 million hybrid gift', on the headline cover page, dated Wednesday, (Sydney, 11 June 2008).

[129] Nick Turse, *The Pentagon's Stealth Corporations* (26 June 2008) Information Clearing House, online at http://www.informationclearinghouse.info/article20178.htm. <Accessed 27.06.08>.

The rich industrialised countries do not follow the free trade policies they demand from developing countries. '*If rich countries honoured their promises to developing countries to deliver improved market access and fairer treatment at the…WTO…, globalization would be producing real benefits for poverty reduction. Unfortunately, Northern governments have failed to act on their commitments. They are maintaining trade policies that skew the benefits of world trade away from poor countries and towards the rich, reinforcing already obscene levels of global inequality in the process.*'[130] Developed countries have collectively reneged on every commitment they have made, and consequently developing countries lose about US$100 billion annually.[131] Trade protectionist policies in industrialised countries that cause developing countries to lose this kind of money are:

- tariff barriers that are four times higher than those in poor countries;
- increased agricultural subsidies that stands at about US$20 billion a year;
- failure to fulfill their commitment to phase out Multi-Fibre Agreement restrictions on textile and garments exports – one of the developing world's most important manufactured exports;
- imposition of some of the highest tariff barriers on their exports from the world's poorest countries – the least developed countries; and
- application of intellectual property and investment rules in a manner that undermines social and economic welfare in poor countries.[132]

[130] Oxfam International, 'Eight Broken Promises: Why the WTO isn't Working for the World's Poor' (Oxfam Briefing Paper 9, Washington D.C., 2001) p.1. Emphasis added.
[131] Id., pp.1-2.
[132] Ibid.

One of the most unfair trade regimes that maintain a system of *robbing from the poor to pay the rich* relates to the last point above – intellectual property rights and prohibiting poor countries from producing their own medicines patented by corporations from the North. In 2001, the WTO members unanimously adopted the following 'Doha Declaration':

> We agree that the TRIPS [Trade-Related Aspects of Intellectual Property Rights] Agreement does not and should not prevent members from taking measures to protect public health… We affirm that the Agreement can and should be interpreted and implemented in a manner supportive of WTO members' right to protect public health and, in particular, to promote access to medicines for all.[133]

However, according to Oxfam, the United States and other rich countries have been applying various tactics to bully developing countries to abrogate and circumvent their commitment to the above declaration. As Oxfam claims:

> The USA does this in a number of ways. It provides biased technical assistance in countries such as Uganda and Nigeria, which benefits its own industry by increasing drug prices and limiting the availability of generics, but reducing access. It uses bilateral and regional free trade agreements to ratchet up patent protection in developing countries. It has recently concluded free trade agreements with Chile and Singapore and is using the high intellectual property standards in the latter as a model for renegotiations on the FTAA (Free Trade Area of the America…and with Central American, Southern African, and other countries. And lastly, the U.S. bullies countries into increasing patent protection by threatening them with trade sanctions under section 301 of the Trade Act of 1974; nearly all those targeted are developing countries, including countries in compliance with their WTO obligations.[134]

[133] *Doha Declaration on the TRIPS Agreement and Public Health*, paragraph 4, adopted on 14 November 2001, available online at http://www.worldtradelaw.net/doha/tripshealth.pdf. <Accessed 01.07.08>.

[134] Oxfam International, 'Robbing the Poor to Pay the Rich? How the United States Keeps Medicines from the World's Poor' (Oxfam Briefing Paper 56, Washington D.C., November 2003) pp.3-4.

By so doing, poor countries are financing the rich countries and their corporate elites. After causing such massive wealth transfers under various schemes as those mentioned above, wealth, which could be used to develop their countries and alleviate poverty, developing countries are condemned for failing to develop and grow.[135] A stinky hypocrisy indeed!

IV. SUMMARY

The net result is that Third World debt is now greater than ever before, and is still increasing in real terms. According to a 2006 estimate by James S. Henry,

> the nominal stock of developing country foreign debt outstanding stood at *$3.24 trillion*. This debt now generates about *$550 billion* of debt service a year for foreign creditors – many First World banks, bond-holders, and multilateral institutions. That $550 billion includes $41 billion a year paid by the world's sixty poorest countries, whose per capita income are all below $825 a year. Even after twenty-five years of debt relief, the annual debt service paid by these countries still almost entirely negates the $40 billion to $45 billion of annual foreign aid they receive. Their debt burden is now a higher percentage of their national income than it was in the early 1980s.[136]

There is very little to show for these debts because the loan funds have long since vanished into paying foreign contractors or corrupt leaders who transferred them into offshore bank accounts, which banks are owned by the very same lenders. The debt repayments are therefore "shark fees" paid to First world creditors.[137] Of the $3.7 trillion

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[135] On wealth transfer from the poor to the rich, even in industrialized countries, see Paul Krugman, *The Great Wealth Transfer (*30 November 2006) posted at http://www.rollingstone.com/politics/story/12699486/paul_krugman_on_the_great_wealth_transfer/print. <Accessed 01.07.08>.

[136] James S. Henry, 'The Mirage of Debt Relief' in Hiatt (ed), above n13, pp.305-362, at pp.308-09.

[137] Id., at p.309.

estimated foreign debt, more than a trillion dollars (i.e. 25% - 35%) were owed by low-and middle-income countries from 1970 to 2004.[138]

Since most resource revenues are caught in the debt trap set up by the First World, developing countries have hardly any money left to develop and industrialise their economies. Debt servicing takes a large bite out of poor countries' export earnings and government revenues, draining funds that are badly needed for health, education, and other forms of public investment.[139] A large segment of the debts developing countries service annually are odious. Notwithstanding the illegality of such debts at international law, the rich creditor countries demand that they be repaid.

Besides *legal* and *illegal* capital flights, there is *human capital flight* also, draining developing countries of development funds and educated elites needed to develop their countries. The estimated net economic value lost by Third World countries from human capital flight alone is $2.5 to $3 trillion as of 2006.[140] The estimated *illegal* capital flight from Africa through corruption and criminal proceeds going into safe havens in First World financial institutions is in the order of $100-$200 billion a year, which dwarfs the $25 billion a year of foreign aid and debt relief Africa receives.[141] This means that for every $1 of foreign aid handed out across the top of the table, some $4-8 in dirty money goes out under the table.[142]

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[138] Id., at p.319.
[139] Id., at p.321.
[140] Henry, above n136., at p.325.
[141] The Africa All Party Parliamentary Group, *The Other Side of the Coin: The UK and Corruption in Africa* (A Report, March 2006) available online at http://www.taxjustice.net/cms/upload/pdf/other_side_of_the_coin_PDF.pdf. <Accessed 27.06.08>.
[142] Id., at pp.14-15.

By employing various forms of debt traps like those examples above, Third World countries have been saddled with a heavy, never-ending debt burden. Neoliberalization and the imposition of SAPs enclose the commons, transfer ownership of the means of production from public hands into private hands, and deepen the debt crisis. Therefore, as Susan George puts it: '*Debt is an efficient tool. It ensures access to other people's raw materials and infrastructure on the cheapest possible terms*.'[143] The forgone conclusion from the forgoing analysis is that, '*While natural resources wealth such as minerals or oil has often contributed to economic mismanagement, its presence alone does not cause mismanagement: the decisive factor is the relationship between foreign and domestic elites*.'[144]

Why has orthodox development theory failed to point to these various forms of capital flight as being responsible for the curse of resource-rich developing countries? Why does orthodox economics recommend policies that exacerbate the curse? What doctor would prescribe to his or her patient medicine that will exacerbate the sickness? Are neoliberal development theorists genuine in their policy prescriptions to alleviate poverty? In the view of this thesis, Deryck Scarr's observation that 'we are a race of robbers and spoilers' quoted at the beginning of this chapter answers these questions. The RCT is indeed a hypocritical neoliberal ideology that seeks to provide a veneer of intellectual respectability to this race of robbers and spoilers in the service of the corporatocracy!

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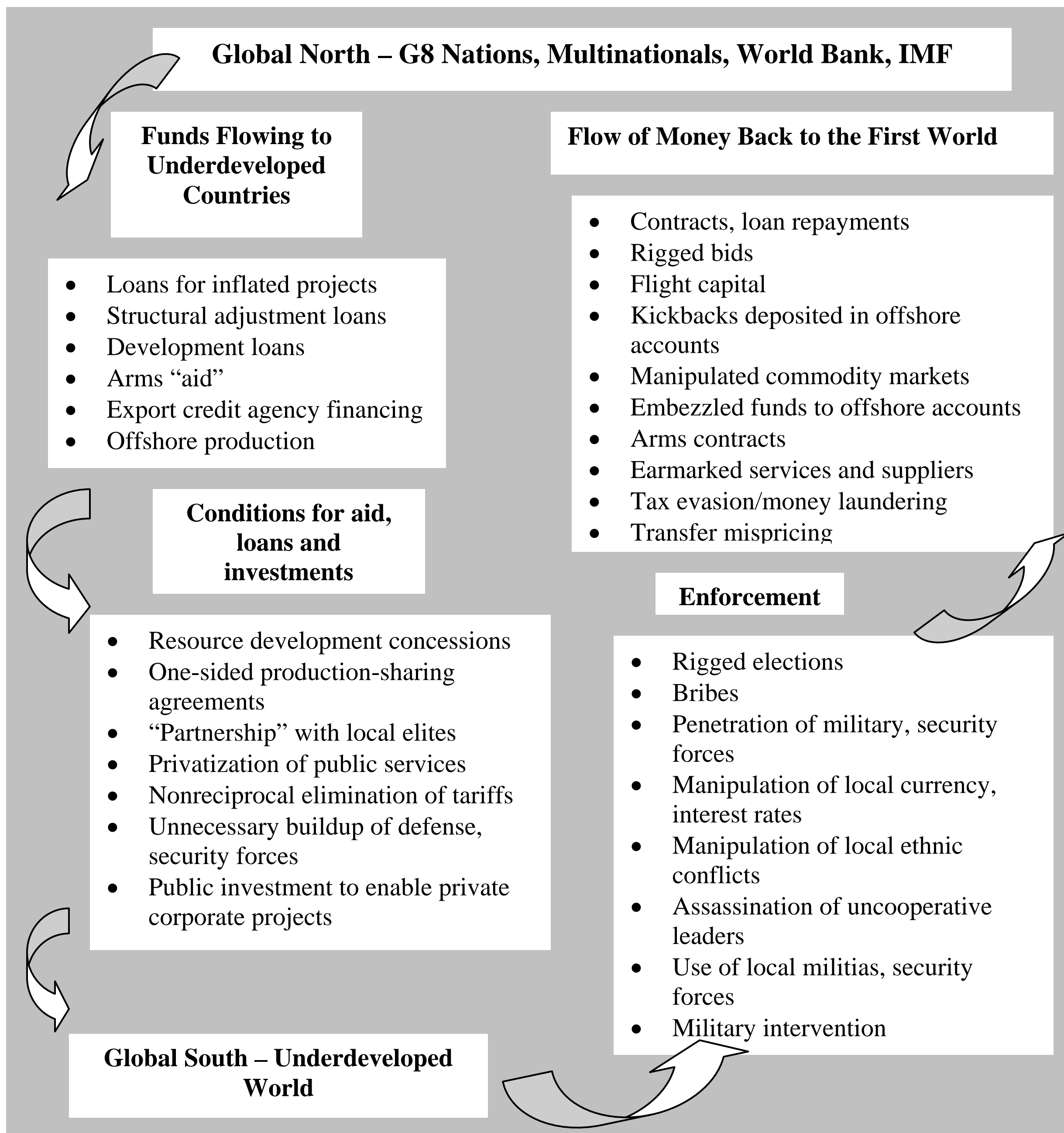
143 George, above n48, pp.143, 187, 235. Emphasis added.

144 Henry, above n136, at pp.320-21. Emphasis added.

Table 8.4 - Flow chart of the Efficient Debt Tool.



Source: *Steven Hiatt*[145]

[145] Steven Hiatt, above n13, at p.30.

CHAPTER NINE

EXTERNAL FACTORS THAT UNDERMINE DOMESTIC INSTITUTIONS

INTRODUCTION

While the resource curse theorists identify strong and good institutions as being important for economic growth, they focus on internal factors of good institutions and fail to consider external factors that undermine institutions. Therefore, the purpose of this chapter is to examine external factors that affect and weaken the emergence of strong and good institutions. The chapter particularly focuses on the role of governments of the industrialised countries, especially the United States government, and transnational corporations in influencing politics, such as regime change, in order to secure oil and mineral contracts in resource-rich developing countries. Section I examines political destabilisation and regime change. Section II provides some case examples of how transnational corporations and their home governments corrupt politicians in developing countries, disregard domestic laws and facilitate money laundering. The final section provides a conclusion.

I. POLITICAL DESTABILIZATION AND REGIME CHANGE

Although institutional theories of the resource curse thesis (RCT) point to weak governments and corruption as contributing factors of the resource curse, these theories do not address *why* governments are weak and corrupt. According to underdevelopment economics and general commentators like John Perkins, sociologists like Noam Chomsky and political economists like J. W. Smith, *imperialism* and *neocolonialism* weaken and

corrupt governments in developing countries.[1] But, as Smith observes, this historical truth '*does not get into high school, or even university, history books…*'[2] While it is not taught in schools, there is overwhelming data detailing the grueling covert operations of economic hitmen (EHM), jackals and military interventions in many resource-rich developing countries by the *corporatocracy*, which weakens popularly-elected governments and corrupt ruling elites who resist or refuse to serve their interests. The following sections examine some representative examples of overt and covert operations causing political destabilisation by the *imperial* and *neocolonial* rulers of the financial-industrial-military complex, headed by the United States of America (U.S.).

A. Latin America

Latin America, much criticized by the RCT, has been the subject of U.S. *neocolonial* and *imperial* policies by successive administrations since the Monroe Doctrine. This doctrine, declared by U.S. President James Monroe in 1823, states '*that the USA would not tolerate any European nation trying to establish a colony in the Americas, and that any attempt to do so would be regarded as a threat to US peace and security.*'[3] Since several European countries were proposing to intervene in former Spanish and Portuguese colonies in Latin and South America, and Russia was attempting to extend its Alaskan territories into Oregon country, Monroe was declaring that, in return for the cessation of such European ambitions, the U.S. would not interfere in European affairs.

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[1] John Perkins, *Confessions of an Economic Hitman: The Shocking Inside Story of How America Really Took Over the World* (first published 2004, 2005 ed); --------, *The Secret History of the American Empire: Economic Hit Men, Jackals, and the Truth About Global Corruption* (2007); J.W. Smith, *Economic Democracy: The Political Struggle of the Twenty-first Century* (4th ed, 2005); Noam Chomsky has written many books on this subject. One of his latest is *Interventions* (2007). See also Peter R. Mitchell and John Schoeffel (eds), *Understanding Power: The Indispensable Chomsky* (2003).

[2] Smith, id., at p.158.

[3] The Free Dictionary online at http://encyclopedia.farlex.com/Munroe+Doctrine. <Accessed 09.06.08>. President James Monroe's speech from which the Monroe Doctrine is derived is available at http://www.famousquotes.me.uk/speeches/James_Monroe/. <Accessed 09.06.08>. Emphasis added.

The doctrine, subsequently broadened, has been a recurrent theme in U.S. foreign policy ever since. By treating Latin America as its private backyard, the U.S. corporatocracy has removed democratically elected leaders who promised to develop and industrialise their countries independent of the U.S., and replaced them with leaders that agreed to American corporate interests. According to John Perkins, one way the corporatocracy exerted control was by empowering autocratic governments in Latin America during the 1970s and imposing economic policies that benefited U.S. investors and international corporations while the local economies faced recessions, inflation, unemployment, and negative economic growth.[4] Despite mounting opposition, Washington propped up 'corrupt leaders who were bankrupting their nations while amassing personal fortunes' and 'supported right-wing dictators and their death squads in Guatemala, El Salvador, and Nicaragua.'[5]

Many writers familiar with Latin American history share the same story in different words.[6] For instance, Noam Chomsky writes:

> The "functions" of Latin America were clarified at a hemispheric conference in February 1945, where Washington proposed an "Economic Charter of the Americas" that would eliminate economic nationalism "in all its forms." Washington planners understood that it would not be easy to impose this principle. State Department documents warned that Latin Americans prefer "policies designed to bring about a broader distribution of wealth and to raise the standard of living of the masses," and are convinced that the first beneficiaries of a country's resources are U.S. investors, while Latin America fulfills its service function without unreasonable concerns about general welfare or "excessive

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4 Perkins (2005), above n1, at p.106.

5 Ibid.

6 For examples, A. Uribe, *The Black Book of American Intervention in Chile* (1975); Stansfield Turner, *Secrecy and Democracy: The CIA in Transition* (1985); Beatriz Manz, *Refugees of a Hidden War: The Aftermath of Counterinsurgency in Guatemala* (1988); Jean-Marie Simon, *Guatemala: Eternal Spring Eternal Tyranny* (1988); Susanne Jonas, *The Battle for Guatemala: Rebels, Death Squads and U.S. Power* (1991).

> industrial development" that might infringe on U.S. interests. The position of the United States prevailed…[7]

Chomsky goes on to point out that beginning with Iran in 1953, the US Central Intelligence Agency (CIA) was involved in many parts of the developing world destabilising and removing political leaders who had genuine concern for the welfare of their people and countries, especially in Latin America.[8] Chomsky refers to President Woodrow Wilson's view of the Monroe Doctrine as one that '*may seem to be based on selfishness alone*,' and '*had no higher or more generous motive*', and the interests of Latin America as merely '*incidental*' to U.S. interests.[9] Based on his personal experience, Perkins, who was serving U.S. corporations in Latin America, Indonesia and Saudi Arabia, supports Chomsky's observations as follows:

> Latin America had become a symbol of U.S. domination. Guatemala under Arbenz, Brazil under Goulart, Bolivia under Estenssoro, Chile under Allende, Ecuador under Roldo`s, Panama under Torrijhos, and every other country in the hemisphere that was blessed with resources that our corporatocracy coveted, and that had enjoyed leaders who were determined to use natural resources for the benefit of their own people, had gone the same route. Everyone of them had seen those leaders thrown out in coups or assassinated and replaced by governments that were puppets of Washington. I had played their game for ten years as an EHM.[10]

Since the 1980s, Latin American development efforts had been shaped by Washington's neoliberal policies imposed through U.S.-based transnational corporations plus the World Bank and the IMF.[11] 'Their agenda for the Latin American and Caribbean region gives

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[7] Noam Chomsky, *Profit Over People: Neoliberalism and Global Order* (1999) p.23.
[8] See Noam Chomsky, *Hegemony or Survival: America's Quest for Global Dominance* (2004).
[9] Chomsky, id., at p.22. Emphasis added.
[10] Perkins (2005), above n1, at p.103.
[11] Naomi Klein, *The Shock Doctrine: The Rise of Disaster Capitalism* (2007).

priority to promoting and protecting the interests of the major investors and transnational corporations that are largely based in the USA and operate in the region.'[12]

Today, however, many Latin American countries are asserting nationalism and pursuing populist development policies. This is threatening U.S. interests, especially by Hugo Chavez's regime in oil-rich Venezuela. 'President Hugo Chávez openly defies the ruling class in the United States, daring to advance universal access to health care and education, to remove itself from the economic orbit dominated by the United States, to diversify its production to meet human needs and promote human development, and to forge an economic coalition between Latin American countries.'[13] The U.S. responded to Chavez's policies by sending its jackals in 2002 to foment a coup in which Chavez was removed, but Chavez supporters in the military later restored him. Eva Golinger, a lawyer trained in New York, with an American and Venezuelan parentage, exposes the extensive involvement of the corporatocracy to destabilize Venezuela and remove Chavez.[14] In an interview with Jean-Guy Allard, a *Granma International* staff writer on 19 May 2008, Golinger said:

> There are distinct factors that I have been able to detect and expose through an investigation that I began more than five years ago…to demonstrate the involvement of the CIA and other U.S. government agencies in the coup against Chavez. The most conclusive facts and evidence include a series of documents classified Top Secret by the CIA, dating from March 5, 2002 to April 17, 2002, which clearly refer to plans for a coup against Chavez… One… particular [document], dated April 6, 2002… [that is] five days

[12] Richard L. Harris, 'Latin America's Response to Neoliberalism and Globalization' (March-April 2008) 214 *Nueva Sociedad* p.2.

[13] Editorial Review of the book *The Chávez Code: Cracking U.S. Intervention in Venezuela* (2006), by Eva Golinger, online at http://www.amazon.com/Bush-Versus-Ch%C3%A1vez-Washingtons-Venezuela/dp/158367165X/ref=pd_sim_b_1. <Accessed 20.06.08>.

[14] Eva Golinger, *The Chavez Code: Cracking U.S. Intervention in Venezuela* is online on Amazon but not available to the writer at this time of writing. Golinger's other book, *Bush Versus Chavez: Washington's War on Venezuela* (2007), is also on Amazon.

> before the coup…[details] how the opposition sectors, the CTV, Fedecamaras (the country's main business federation), dissenting soldiers, the private media and even the Catholic Church were going to march through the streets in those first weeks of April and how the coup conspirators would provoke violence with snipers in the street, causing death, and then the intention to arrest President Chavez and other important members of his cabinet. Any one who knows what happened that April 11-12, 2002, knows that that's how it was, and after taking President Chavez prisoner, it was only the U.S. government spokespersons who came out and recognized the coup government of Pedro Carmona, and...tried to…pressure…other countries to do the same.[15]

Golinger reveals that the CIA was not alone in the coup plot. It was financially supported by a number of other U.S. institutions like the National Endowment for Democracy (NED), the International Republican Institute (IRI), the National Democratic Institute (NDI), USAID, and the Centre for International Private Enterprise (CIPE) who paid civil society groups (NGOs), trade unions, business people, opposition political parties and the media. The activities of the U.S. and its institutions have not ceased after the failed coup. 'The U.S. embassy in Venezuela is very active. These days, its main strategy is subversion. This is manifested by USAID, NED, IRI, Freedom House, CIPE, etc. funding…opposition groups…[and] there is also an attempt to penetrate the pro-Chavez sectors and communities.'[16]

The involvement of civil society organizations, research institutions, pro-democracy institutions and churches who are pro-poor, pro-society and pro-democracy in destabilising and removing democratically-elected governments is indeed disheartening. This creates a global culture of distrust and deception such that one finds it difficult to

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[15] Golinger, interview recorded by Jean-Guy Allard, 'The CIA is More Active than Ever in Venezuela' from *Information Clearing House* sent to me by email on 20.05.08, available online at http://www.informationclearinghouse.info/article19954.htm.

[16] Ibid.

trust anyone, even those with good intentions.[17] Through funding arrangements, the CIA and the US government use these institutions as fronts. As Golinger explains:

> The CIA and the State Department maintain various fronts in the country, as they always do. We have Development Alternative Inc. (DAI), a U.S. corporation based in the El Rosal de Caracas sector, which functions as a money filter from USAID to the opposition sectors. Then there is the Press and Society Institute, part of the Reporters sans frontiers (RSF) network, which receives funds from the NED, USAID, the CIA etc. to execute its neoliberal, pro-U.S. policy and to attempt to accuse the Venezuelan government of being repressive and violating the rights of free expression and a free press. Freedom House and the USAID are also financing right-wing student leaders and movements and sending them to Belgrade to train with experts in the Orange Revolution (Ukraine) and other so-called processes for "overthrowing dictator". Recently, the neoliberal right-wing Cato Institute think tank, which advises Bush and receives funding from Exxon Mobil and Philip Morris, awarded a "prize" worth $500,000 to the opposition Venezuelan student Yon Goicochea. The prize, which bears the name of Milton Friedman, who was an advisor to Nixon, Reagan and Pinochet and is the architect of the neoliberal policy and the "shock doctrine", is to finance new, "fresh-faced" political party in Venezuela – a group of young people trained since 2005 by U.S. agencies that have had some influence over certain sectors during the last years. With new CIA Special Mission for Venezuela and Cuba (set up in 2006), we know that the Agency is more active than ever in the country. The stronger and more popular Chavez and the revolution become, the more resources they are dedicating to neutralize it.[18]

During his rule, Chavez has made a number of improvements. 'Among these include the lowering of inflation, of poverty, and of inequality, and the increase in school attendance and in access to drinking water, among other things.'[19] To the corporatocracy, these achievements are a threat to their profit interest, code-named 'national interest'. Therefore, the jackals are still out there seeking to hunt down Chavez. "In an interview

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[17] The grand merger of the corporatocracy and global civil society groups in the pursuit of transparency and good governance under *Extractive Industries Transparency Initiative* (EITI) is revealing here.

[18] Golinger, id., at pp.2-3.

[19] Stuart Munckton, 'Venezuela: Chavez reflects on social gains', *Green Left Online* (7 February 2008) at http://www.greenleft.org.au/2008/739/38239. <Accessed 24.06.08>.

on Miami's Spanish-language Channel 22, the former CIA agent Felix Rodriguez said that the U.S. government has plans to 'bring about a change in Venezuela.'[20] The British newspaper *Financial Times* reported: 'Senior US administration officials are working on a policy to 'contain' President Hugo Chavez.' The report went on to say that a strategy aimed at fencing in the Chávez government was being prepared at the behest of President Bush and Condoleezza Rice, the Secretary of State.[21] Some EHM argue that Chavez is a threat to the US 'national interest' not warranting military intervention but *containment,* which would include regime change and assassination. 'Chavez is a threat to U.S. interests, but not yet an existential one. He possesses the desire and the means to oppose U.S. objectives, and to threaten U.S. allies, but he has been prudent enough to avoid provoking a military confrontation with the U.S.'[22]

These accounts are nothing new. Some retired U.S. military personnel who loyally served the corporatocracy in previous decades to destabilize governments in Latin America and elsewhere who refused to serve U.S. interests similarly confess their guilt like Perkins.[23] General Smedley Butler is one of those who confesses:

> I spent thirty-three years and four months in active service as a member of our country's most agile military force – the US Marine Corps…. And during that period I spent most of my time being a high-class muscle man for big business, for Wall Street and for the bankers. In short, I was a racketeer for capitalism. Thus I helped make Mexico and especially Tampico safe for American oil interests in 1914. I helped make Haiti and Cuba a decent place for the National City Bank boys to collect revenues in. I helped purify Nicaragua for the international banking house of Brown Brothers in 1909-12. I

[20] Gregory Wilpert, *Former CIA Agent Affirms Possibility of Chavez's Assassination in Venezuela* (15 March 2005) available at http://www.venezuelanalysis.com/news/1004. <Accessed 24.06.08>.

[21] Ibid.

[22] Mark J. Powell, 'The U.S. and Chavez: To Confront or to Contain?' (Paper submitted to the Faculty of the Naval War College in partial satisfaction of the requirements of the Department of Joint Military Operations, Naval War College, U.S. Department of State, 23 October 2006).

[23] William Blum, *Killing Hope: U.S. Military and CIA Interventions Since World War II* (2003).

> brought light to the Dominican Republic for American sugar interests in 1916. I helped make Honduras 'right' for American fruit companies in 1913. In China in 1927 I helped see to it that Standard Oil went its way unmolested.[24]

Many populist leaders have been elected into power in some Latin American countries in recent years. Luiz Inacio da Silva was elected in a landslide victory in Brazil in 2002. President Rafael Correa of Ecuador is another. These leaders who truly want to use their revenues from natural resources to alleviate poverty and develop their countries are a threat to the corporatocracy.[25] The jackals are already in these countries scheming ways to overthrow these leaders. In April 2008, the Ecuadorian president declared publicly 'that Ecuador's intelligence systems were "totally infiltrated and subjugated to the CIA," and accused senior Ecuadorian military officials of sharing intelligence with Colombia, the Bush administration's top…ally in Latin America.'[26] In June 2008, the jackals have also attempted to take out the Bolivian president who is described by the corporate media as "leftist" to mean "pro-poor", nationalist and "pro-development" or populist.[27]

B. Iran

The corporatocracy follows the same strategy in the oil-rich countries of the Middle East to remove leaders who refuse to serve their imperialistic interests. In Iran the CIA trained the Iranian Secret Service, codenamed SAVAK, and overthrew the democratically elected leader Dr. Mohammad Mossadegh in 1953. Great Britain, fearful of Iran's plans

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[24] Smedley D. Butler, *War is a Racket* (Los Angelis: Feral House, 2003), quoted by Smith, above n5, at p.159. See also Frederic F. Claimont, *Rise and Fall of Economic Liberalism* (Goa, India: The Other India Press, 1996) p.223.

[25] Perkins, above n13, at p.113.

[26] William Blum, *The CIA and the Raid on Ecuador: Spies Without Borders* (2 May 2008) – *counterpunch* - online at http://www.counterpunch.org/blum05022008.html. <Accessed 27.05.08>.

[27] Carlos Valdez, 'Bolivia officials say suspects arrested in possible plot to kill president' *Santa Barbara News* (20 June 2008) online at http://www.newspress.com/Top/Article/article.jsp?Section=WORLD&ID=565318615268983936. Posted to me via email by *Information Clearing House* on 22 June 2008.

to nationalize its oil industry, came up with the idea for the coup in 1952 and pressed the U.S. to mount a joint operation to remove the prime minister.[28] The CIA and the British Intelligence Service (BIS) handpicked Gen. Fazlollah Zahedi to succeed Prime Minister Mohammed Mossadegh and covertly funneled $5 million to General Zahedi's regime two days after the coup prevailed. Iranians working for the CIA and posing as Communists harassed religious leaders and staged the bombing of one cleric's home in a campaign to turn the country's Islamic religious community against Mossadegh's government. Fearful of risking his throne, the Shah repeatedly refused to sign CIA-written royal decrees to change the government. The agency then arranged for the Shah's twin sister, Princess Ashraf Pahlevi, and Gen. H. Norman Schwarzkopf, the father of the 1991 Desert Storm Commander, to act as intermediaries to try to keep him from wilting under pressure, but he fled the country just before the coup succeeded.[29] 'Under the reinstalled Shah, Gulf Oil, Standard Oil of New Jersey, Texaco, and Socony-Mobil gained 40% share of Iranian oil rights (Britain, the original planner of this regime change, claimed the remaining rights).'[30] The Iranian Revolution of 1979 brought an end to this Western corporate monopoly over Iran's oil wealth.

But the corporatocracy is not finished with Iran yet. Since attempts at regime change by EHM and jackals have failed,[31] the U.S. and its allies are preparing for military

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[28] James Risen, 'Secrets of History: The C.I.A. in Iran' (16 June 2000) *The New York Times*, on the web at http://www.nytimes.com/library/world/mideast/041600iran-cia-index.html. <Accessed 20.06.08>. American media first publicly broadcasted the CIA overthrow of Mossadegh in 1987, which is now available on YouTube in video form dated 6 December 2006 at http://www.youtube.com/watch?v=iaGCJmCAJ40. <Accessed 20.06.08>.

[29] Risen, ibid.

[30] Smith, above n1, at p.159.

[31] Andre Cockburn, in *Secret Bush "Finding" Widens War on Iran* (2 May 2008) published online by *counterpunch* at http://www.counterpunch.org/andrew05022008.html, reports that 'President Bush signed a secret finding authorizing a covert offensive against Iranian regime' by arming and funding Iranian Kurdish nationalists as well as Sunni group in Iranian Baluchistan across the Afghan border, as well as other groups in Lebanon. <Accessed 27.05.08>. Major news outlets on 29 June 2008 reported

intervention in Iran, but the Obama Administration might change that momentum.[32] In his last presidential 'farewell' tour in Europe in June 2008, Bush told his allies that military action 'is still on the table' if Iran fails to respond to economic sanctions and diplomatic pressure to abandon its nuclear weapons program.[33] After his 90-minute meeting with President Bush on 4 June 2008, Israeli Prime Minister Ehud Olmert said the two leaders were of one mind, and reached an agreement to deal with the Iranian threat before the end of Bush's term.[34] In accordance with that agreement, Israel has set up an "Iran Command" for war within its airforce[35] and carried out a major military exercise in June 2008 involving over 100 fighter jets.[36] A Pentagon official said one of Israel's goals 'was to practice flight tactics, aerial refueling and all other details of a possible strike against Iran's nuclear installations and its long-range conventional missiles.'[37] According to America's National Intelligence Estimate released in December 2007, Iran abandoned its nuclear weapons' program three years ago.[38] That report confirmed the International Atomic Energy Association's (IAEA) own repeated assessment over five

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that the US had received Congressional funding of $400 million to conduct covert operations to bring about regime change in Iran.

32 See Mehrnaz Shahabi, 'The War Camp in Death Throes is Intent on Striking Iran' (25 May 2008) *Information Clearing House* online at http://www.informationclearinghouse.info/article19981.htm. <Accessed 27.05.08>.

33 Colin Brown (Deputy Political Editor), 'Bush Threatens Iran with Military Action', *The Independent*, dated Tuesday 17 June 2008, from the online version at http://www.independent.co.uk/news/world/politics/bush-threatens-ir... <Accessed 17.06.08>. After Bush's tour, the U.S. House of Representatives passed a resolution on 19 June 2008, effectively requiring a naval blockade on Iran, signalling yet again that military intervention is imminent: Andrew W. Cheetham, 'House Resolution Calls for Naval Blockade Against Iran' sent by email from *Information Clearing House* on 20 June 2008.

34 Quoted by Ray McGovern, 'Bomb Iran? What's to Stop Us?' *Information Clearing House* dated 20 June 2008 at http://www.informationclearinghouse.info/article20140.htm. . <Accessed 23.06.08>. The two leaders have left office in early 2009, leaving the job to their successors. President Barack Obama appears to prefer diplomacy over war whereas Prime Minister Benjamin Netanyahu of Israel appears to prefer some sort of military action.

35 PressTV, 'Israel launches 'Iran Command' for war'` online at http://www.presstv.ir/detail.aspx?id=59400§ionid=351020104. <Accessed 23 June 08.

36 Michael R. Gordon and Eric Schmitt, 'U.S. Says Israeli Exercises Seemed Directed at Iran', *The New York Times* dated 20 June 2008, online at http://www.nytimes.com/2008/06/20/washington/20iran.html?_r=2&oref=slogin&partner=rssuserland&emc=rss&pagewanted=print&oref=slogin. <Accessed 23.06.08>.

37 Ibid.

38 Charley Reese, 'Insanity', *Information Clearing House*, dated 25 May 2008, online at http://www.informationclearinghouse.info/article19988.htm. <Accessed 27.05.08>.

years of intrusive inspections, which Vice President Dick Cheney prevented its publication for over a year.[39] But since the resignation of Admiral Fallon, the ex-head of the U.S. Central Command who opposed war with Iran, the US war propaganda machine has relentlessly accused Iran of producing weapons of mass destruction.[40] That accusation is still going on under the Obama administration in 2009 despite Obama's reconciliatory tones.

If Iran has given up is nuclear programs, then what is the threat that Iran poses to the United States? One simple and obvious answer is Iran's oil. After securing Iraq's massive oilfields (as we shall see below), the corporatocracy is now seeking to confiscate and secure Iran's oil and gas resources. The next and perhaps more important motivation often unpublicized by the corporate media is Iran's pricing of oil in euro. Iran and other OPEC countries want to end the dollar hegemony by introducing real competition in the oil market. In 2005-2006, the government of Iran planned to open an Iranian Oil Bourse (IOB), an oil exchange program, to compete with New York's NYMEX [New York Mercantile Exchange] and London's IPE [International Petroleum Exchange] with respect to international oil trades using a euro-denominated international oil-trading mechanism.[41] The IOB is a marketplace for buying and selling petroleum. This has seriously threatened U.S. world dollar hegemony. Since the oil-backed-dollar is one of the pillars holding up the American economy, the second pillar being its military

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[39] Mehrnaz Shahabi, 'The War Camp in Death Throes is Intent on Striking Iran', *Information Clearing House* dated 25 May 2008 online at http://www.informationclearinghouse.info/article19981.htm. <Accessed 27.05.08>.

[40] For details of the various accusations, see Shahabi, ibid. See also Campaign Against Sanctions and Military Intervention in Iran (CASMII), 'The War Camp in Death Throes is Intent on Striking Iran' dated Saturday 24 May 2008, online at http://www.campaigniran.org/casmii.index.php?q=node/5046/print. <Accessed 27 May 2008>.

[41] Joshua Frank, War with Iran (24 January 2006) ZNet, at http://www.zmag.org/znet/viewArticle/4558. <Accessed 23.06.08>. U.S. corporations such as Chase Manhattan and Citicorp own both the NYMEX and the IPE.

supremacy, Iran's actions have indeed threatened U.S. 'national interests'.[42] William Clark puts it this way:

> The Iranians are about to commit an 'offense' far greater than Saddam Hussein's conversion to the euro of Iraq's oil exports in the fall of 2000. Numerous articles have revealed Pentagon planning for operations against Iran as early as 2005. While the publicly stated reasons will be over Iran's nuclear ambitions, there are unspoken macroeconomic drivers explaining the real reasons regarding the 2nd stage of petrodollar warfare – Iran's upcoming euro-based oil Bourse…. This means that without some form of US intervention, the euro is going to establish a firm foothold in the international oil trade. Given U.S. debt levels and the stated neoconservative project for U.S. global domination, Tehran's objective constitutes an obvious encroachment on U.S. dollar supremacy in the international oil market…[43]

Many other observers concur with Clark's assessment. For example, as Italy's *Panorama* newsmagazine puts it: 'The weapon of oil in the hands of Iran's regime is more dangerous than any other weapon.'[44] For Mike Whitney, since the petrodollar system is no different than the gold standard, America will fight to defend it.

> Today's currency is simply underwritten by the one vital source of energy upon which every industrialized society depends - oil. If the dollar is de-linked from oil; it will no longer serve as the de-facto international currency and the US will be forced to reduce its massive trade deficits, rebuild its manufacturing capacity, and become an export nation again. The only alternative is to create a network of client regimes who repress the collective aspirations of their people so they can faithfully follow directives from Washington. As to whether the Bush administration would start a war to defend dollar hegemony; that's a question that should be asked of Saddam Hussein. Iraq was invaded

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[42] See *the treacle mine* online at http://www.thetreaclemine.com/2008/05/02/iranian-oil-bourse/. <Accessed 23.06.08>.

[43] William Clark, 'The Real Reasons Why Iran is the Next Target: The Emerging Euro-dominated Oil Marker' dated 27 October 2004, online at http://globalresearch.ca/articles/CLA410A.html. <Accessed 23.06.08>.

[44] Quoted by Niusha Bograti, *Iran's Oil Burse: A Threat to the U.S. Economy* (11 April 2006) Worldpress.org online at http://www.worldpress.org/Mideast/2314.cfm. <Accessed 23.06.08>.

> just six months after Saddam converted to the euro. The message is clear; the Empire will defend its currency. Similarly, Iran switched from the dollar in 2007 and has insisted that Japan pay its enormous energy bills in yen. The 'conversion' has infuriated the Bush administration and made Iran the target of US belligerence ever since. In fact, even though 16 US Intelligence agencies issued a report (NIE) saying that Iran was not developing nuclear weapons; and even though the UN's nuclear watchdog, the IAEA, found that Iran was in compliance with its obligations under the Nuclear Nonproliferation (NPT) Treaty; a preemptive US-led attack on Iran still appears likely.[45]

Iran's Oil Bourse began trading on 18 February 2008.[46] According to many observers, the U.S. views this development could set the precedent for other commodities to be traded in currencies other than the dollar, thereby further weakening U.S. global economic hegemony.[47] Indeed, American accumulation through recycling petrodollar is under serious threat. '*Many believe that the Sub-Prime crisis is the tip of the iceberg. There are signs that there is a severe recession around the corner. The Oil bourse would severely exacerbate financial matters for the US Dollar. The rise of 125 points in interest rates affects the 1 Trillion that the Arabs have invested in America. There are some indications that some of this money is being moved slowly. This would destroy the American economy and bring untold misery to the investors and businesses*.'[48] Therefore, whoever threatens American corporate interest faces American military power. This is NOT a case of *free market* comprising free producers of oil selling to free buyers in any currency the parties prefer in a *competitive* globalized economy without

45 Mike Whitney, 'Fragile Dollar Hegemony: Iran's Oil Burse Could Topple the Dollar' (4 February 2008) *Global Research*, online at http://globalresearch.ca/index.php?context=va&aid=7998. <Accessed 23.06.08>.

46 Pepe Escobar, 'Slouching Towards Petroeurostan', *Asia Times Online* dated 21 February 2008, at http://www.atimes.com/atimes/Global_Economy/JB21Dj07.html. See also *Seeking Alpha* online at http://seekingalpha.com/article/65003-iranian-oil-bourse-starts-trading-sans-dollar-contracts#comment_form. <Both accessed 23.06.08>. The Iranian Oil Minister opened the IOB on Sunday, 17 February 2008.

47 Seeking Alpha, ibid. Pepe Escobar, 'Russ Gas Pac Energizes Iran' (27 February 2007) *Asia Times Online*, at http://www.atimes.com/atimes/Middle_East/JB27Ak01.html. <Accessed 23.06.08>.

48 Moin Ansari, *Dogs of War: Iran Oil Bourse vs US Dollar:-Analysis* online at http://rupeenews.com/2008/02/11/the-dogs-of-war-iranian-oil-bourse-opens-and-challenges-the-dollar-on-feb-11th-2008/. <Accessed 23.06.08>. Emphasis added.

government intervention as the neoliberal gurus preach to Third World citizens. '*There is no free market in the oil industry. ... There is no free market at the pump, either*.'[49]

C. Iraq

To many learned observers today Iraq was invaded to confiscate its oilfields by the corporatocracy and to maintain the dollar hegemony as the world's reserve currency.[50] William Clarke leaves no doubt about this when he observes:

> What motivated the Bush administration to invade Iraq? The simplistic answer is to preserve U.S. global dominance. Moreover, a little known fact bellies the deeper reasons for the invasion: in order to prop up the US's declining economic status as the sole superpower, its military force was required to gain strategic control of Iraq's oil supply and oil currency for both macroeconomic and geostrategic considerations. More specifically, this was a war to gain control over Iraq's hydrocarbon reserves and, in doing so, maintain the US dollar as the monopoly currency for the critical international oil market. It was, and is, about retaining the dollar as the world's reserve currency, and it is also about securing its continued use as a mechanism for effortless US credit expansion and supremacy… Although completely unreported by our government and the US corporate media, one of the answers to the enigma surrounding the Iraq War was the simple yet shocking realization that it was partly an oil currency war waged by the US against the euro, currency of the European Union (EU). The calculated goal of regime change in Iraq was designed to prevent further momentum within the Organization of

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[49] Jim Hightower, 'Big Oil's Free-Market Hokum', posted on Tuesday 8 June 2008, at http://www.jimhightower.com/node/6509. <Accessed 04.07.08>. Emphasis added.

[50] Alan Greenspan, the self-confessed libertarian who was chairman of the US Federal Reserve System from the reign of Reagan, Clinton and the Bushes (Sr. and Jr.) made this admission. See Graham Patterson, 'Allan Greenspan Claims Iraq War Was Really for Oil' in *Times Online* dated 16 September 2007 at http://www.timesonline.co.uk/tol/news/world/article2461214.ece. <Accessed 23.06.08>. Greenspan wrote: 'I am saddened that it is politically inconvenient to acknowledge what everyone knows. The Iraq war is largely about oil.' Quoted from *The Age of Turbulence* on Bob Fertik's Blog at http://www.democrats.com/greenspans-inconvenient-truth-we-invaded-iraq-for-oil. Dated 16.09.07. <Accessed 23.06.08>. Scott McClellan, Bush's White House Press Secretary and stout defender of the Iraq invasion policy is the latest critic who was 'blind' but now he could see. See his book *What Happened: Inside the White House and Washington's Culture of Deception* (2008).

> Petroleum Exporting Countries (OPEC) toward the euro as an alternative oil transaction currency.[51]

When Iraq was paid in euro during the United Nation's oil-for-food program, it had earned about 26 billion euro for about 3.3 billion barrels of oil deposited into its escrow account in New York. Since the euro was buying $0.80 at the time of the move, the UN issued a report warning that the move would cost Iraq up to 270 million pounds.[52] However, the Iraqi account was not only earning higher rate of interests, but also the ability to pay mainly European suppliers in euro enabled Saddam Hussein to make hundreds of millions for the Iraqi oil-for-food program.[53] Two months after the U.S. invasion in 2003, Iraq oil was switched back to dollar. 'Global dollar supremacy was once again restored. Bush descended victoriously from a fighter set and declared the mission accomplished – he had successfully defended the U.S. dollar, and thus the American Empire.'[54]

After having removed Saddam Hussein, America imposed its own laws and set up a puppet government that would rubber-stamp U.S. 'national interest'. In February 2007, the government of Prime Minister Nuri al-Maliki approved Iraq's new U.S.-drafted petroleum legislation. According to Pepe Escobar,

> The key point of the law is that Iraq's immense oil wealth (115 billion barrels of proven reserves, third in the world after Saudi Arabia and Iran) will be under the iron rule of a fuzzy "Federal Oil and Gas Council" boasting a "panel of oil experts from inside and

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51 William R. Clarke, *Petrodollar Warfare: Oil, Iraq and the Future of the Dollar* (2005) pp.3-4.

52 The International Workers Association, 'Iraq, Oil and U.S. World Hegemony (I) and (II)' online at http://www.iwa-ait.org/index.html. <Accessed 15.06.08..

53 Faisal Islam, 'Iraq nets handsome profit by dumping the dollar for euro' in the *Guardian* dated Sunday 16 February 2003, online at http://www.guardian.co.uk/business/2003/feb/16/iraq.theeuro/print. <Accessed 09.0608>.

54 Krassimir Petrov, *Iranian Oil Bourse will accelerate the fall of the American Empire* (17 January 2006) online at http://www.sciforums.com/showthreat.php?t=51621. <Accessed 23.06.08>.

> outsider Iraq". That is, nothing less than predominantly US Big Oil executives. The law represents no less than institutionalized raping and pillaging of Iraq's oil wealth. It represents the death knell of nationalized (from 1972-1975) Iraqi resources, now replaced by production-sharing agreements (PSAs) – which translate into savage privatization and monster profit rates of up to 75% for (basically US) Big Oil. Sixty-five of Iraq's roughly 80 oilfields already known will be offered to Big Oil to exploit…. The law in essence drafted, behind lock doors, by a US consulting firm hired by the Bush administration and then carefully retouched by Big Oil, the International Monetary Fund, former US deputy defense secretary Paul Wolfowitz' World Bank, and the United States Agency for International Development [USAID]. It is virtually a US law (its original language is English, not Arabic).[55]

This *imperial* program has been planned for some time before terrorists crashed into the Twin Towers of the World Trade Center in New York on 11 September 2001. Greg Muttitt, who supports Perkins' account of exploitation by the corporatocracy, provides a key piece of evidence on this. He points out that before Dick Cheney was appointed vice president, he was the chief executive officer (CEO) of Halliburton. As a CEO, Cheney was concerned about constrained oil supplies. Cheney is recorded to have said: 'By 2010 we will need on the order of an additional fifty million barrels a day. So where is the oil going to come from? … While many regions of the world offer great oil opportunities, the Middle East, with two-thirds of the world's oil and the lowest cost, is still where the prize ultimately lies.'[56] Muttitt also refers to similar sentiments expressed by ConocoPhillips and Shell before the Iraqi invasion.[57]

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[55] Pepe Escobar, 'US's Iraq Oil Grab a Done Deal' in *Asia Times Online* dated 28 February 2008 online at http://www.atimes.com/atimes/Middle_East/IB28Ak01.html. <Accessed 28.05.08>.

[56] Dick Cheney, speech at the Institute of Petroleum Autumn Lunch, London, 15 November 1999, quoted by Greg Muttitt in 'Hijacking Iraq's Oil Reserves: Economic Hit Men at Work' in Steven Hiatt (ed), *A Game as Old as Empire: The Secret World of Economic Hit Men and the Web of Global Corruption* (2007) pp.185-217, at p.185.

[57] Muttitt, id., at p.186. Cf. Carola Hoyos, 'Big Players Anticipate Iraq's Return to Fold' *Financial Times* dated 20 February 2003; and *Shell in the Middle East*, Shell corporate magazine, dated April 2005.

The private consulting firm, International Tax and Investment Centre (ITIC), headed by Dan Witt, drafted Iraq's production-sharing agreement (PSC, or PSA). Witt was instrumental in the neoliberal market reforms in New Zealand in the early 1980s, and Russia and Eastern Europe in the 1990s and thereafter.[58] ITIC is a 'non-profit' organization, which receives funds from some of the world's largest global corporations. Some members on the board of ITIC are senior officers from these donor corporations. One oil company executive described the ITIC as '*a private-sector version of the OECD or IMF*.'[59] The production-sharing contract (PSC) imposed on Iraq was based on the model drafted by ITIC and imposed in Russia and the transitional countries in Eastern Europe.[60] A production-sharing contract can be described as a politically useful symbol which gives the appearance of a service contract to the state company acting as master and the international company as a mere service provider, hiding the real power relations of control. This means the 'government can be seen to be running the show – and the company can run it behind the camouflage of legal title symbolizing the assertion of national sovereignty.'[61] As it stands, the law represents 'a momentous shift in state policy and reversal of measures begun in Iraq as far back as 1961, which culminated in the nationalization of the oil industry in 1972-75. It is also a departure from practices that have been universal in the major oil-exporting countries since the 1970s whereby

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[58] See ITIC, *Petroleum and Iraq's Future: Fiscal Options and Challenges*, in cooperation with Oxford Economic Forecasting, Centre for Global Energy Studies and Transborder, (Washington D.C., ITIC, Fall 2004). This document can be download from http://www.iticnet.org. <Accessed 23.06.08>. Muttitt, above n56, provides a detail analysis of ITIC's history and activities.

[59] Ken Potter, Vice President of Chevron Overseas, quoted by Muttitt, id, at pp.187-88. Italics supplied.

[60] Some observers say that Bearingpoint Inc., a Virginia-based company contracted by USAID prepared the PSC based on Latin American models: see Joshua Holland, 'The Great Iraq Oil Grab' posted on AlterNet dated 22 May 2006, at http://www.alternet.org/module/printversion/36463. <Accessed 19 May 2008>. I have fully examined the history and salient features of PSCs and other oil instruments in *An Examination of Papua New Guinea's Petroleum Law and Policy*, a Master of Laws (Honours) Thesis submitted to the Faculty of Law, University of Wollongong, 1997.

[61] Thomas W. Wade, 'The Current Status of International Petroleum Investment: Regulating, Licensing, Taxing and Contracting' (July 1995) 5 *CEPMLP Journal* p.1, quoted in Muttitt, above n56, at p.205.

resources are publicly owned and production operations are mainly carried out by state-owned companies and managed nationally.'[62]

The economic consequence of the PSC is that, based on the price of $40 per barrel, oil from twelve production fields prioritized for development would rob Iraq of between $74 billion and $194 billion under the PSC.[63] 'To put this amount in perspective, it could be as much as six times Iraq's current gross domestic product. If the price of oil were to stay high…the loss to Iraq would be correspondingly high.'[64] On the other hand, 'the oil bonanza for the oil giants from the invasion of Iraq could run into trillions. … The decision by the US occupation to apply this PSA model to Iraq amounts to naked corporate plunder.'[65] Indeed, this is the ultimate outcome the British and the U.S. corporatocracy desired long before the Iraqi invasion in 2003.[66]

In order to perpetuate control over the oil reserves not only in Iraq but also other parts of the Middle East, the United States is now seeking permanent bases for its military inside Iraq indefinitely after the UN mandate to remain there ends in 2008. 'The US is 'negotiating' a treaty with the Iraqi government, one that would replace the UN mandate and legalize the US occupation of Iraq indefinitely. … By signing a long-term treaty, the Bush administration would pre-empt any action by a future Democratic president of Iraq.'[67] The treaty serves a number of purposes. First, it avoids the U.S. Senate voting

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[62] Kamil Mahdi, 'Iraq's Oil Law: Parsing the Fine Print' (Summer 2007) *World Policy Journal* pp.11-23, at p.11. Mahdi provides detail analysis of the legal ramifications of the imposed oil law.

[63] Muttitt, above n56, at pp.207-208.

[64] Ibid.

[65] James Cogan, 'Report outlines plans for corporate plunder of Iraqi oil', dated 8 December 2005 at *World Socialist Web Site*, at http://www.wsws.org/articles/2005/dec2005/oil-d08_prn.shtml. <Accessed 09.06.08>.

[66] Greg Muttitt, 'Crude Designs: The Rip-Off of Iraq's Oil Wealth' (PLATFORM, London, November 2005).

[67] Ramzy Baroud, 'Legalizing Occupation: Bush's Last Manoeuvre in Iraq' *Information Clearing House*, sent to me by email on 18 June 2008.

on the treaty; the U.S.-Iraq treaty is merely labeled as a 'status of forces agreement' (SOFA), which the U.S. executive arm of the government can negotiate and settle without Senate vote.[68] Second, Iraq will become a client state of the U.S. in which the U.S. will keep more than 50 military bases, and its forces will not be subject to the laws of Iraq.[69] Third, the SOFA is forced upon Iraq with the threat of withholding Iraqi assets, some $20 billion dollars, held in the Federal Reserve Bank of New York to satisfy Iraq's odious debts under Saddam Hussein.[70] Finally, for stability because the invasion had segregated the Iraqi society into Sunnis, Shiites and Kurds warring against each other, making post-Sadam Iraq volatile and too weak to be on its own.[71]

Despite spending trillions of dollars, the Iraqi security personnel has not been adequately trained and prepared to secure their new democracy – and this purposely - so that Iraq would continue to rely on the U.S. for security. After all, the real interest of the corporatocracy is not a strong nation-state, but oil.[72] As the *U.S. Crusade News* reveals:

> The ugly truth behind the Iraq and Afghanistan wars finally has emerged. Four major western oil companies, Exxon Mobil, Shell, BP and Total are about to sign U.S.-brokered no-bid contracts to begin exploiting Iraq's oil fields. Saddam Hussein had kicked these firms out three decades ago when he nationalized Iraq's oil industry. The U.S.-installed Baghdad regime is welcoming them back. Iraq is getting back the same oil companies

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68 Patrick Cockburn, 'US issues threat to Iraq's $50bn foreign reserves in military deal', *The Independent* (Friday 6 June 2008) online at http://www.independent.co.uk/news/world/middle-east/us-issues-thre... <Accessed 09.06.08>.

69 Ibid.

70 Deborah Haynes, 'Treaty tensions mount as Iraq tells the US it wants all troops back in barracks' (9 June 2008) *Times Online* at http://www.timesonline.co.uk/tol/news/world/iraq/article4092919.e... <Accessed 09.06.08>.

71 Mahdi, above n62, explains that the imposed constitution and oil law was deliberately drafted in such a way that ownership in natural resources vested in the people of Iraq gives each of the regional governments power to control oil development and revenue in their regions without oversight, control and management from the central government, which is why Kurdistan is claiming the right to exploit oil in its region with foreign oil companies.

72 On the cost of war, see Joseph Stiglitz and Linda Bilmes, *The Three Trillion Dollar War: The True Cost of the Iraqi* Conflict (2008).

> that used to exploit it when it was a British colony. … The invasion was about [primitive accumulation], not democracy.[73]

However, 'President Bush repeatedly asserts that the US has conferred the precious gift of "freedom" on the Iraqi people. "Freedom", he says, "is the Almighty's gift to every man and woman in this world" and "as the greatest power on earth we have an obligation to help the spread of freedom".'[74] The prize paid for Iraq's *freedom* and *democracy* is over one to two million Iraqi lives, the lives of more than 4,000 U.S. soldiers, and over trillions of dollars.[75] Even a fool would not believe that such a high prize is being paid for Iraqi freedom and democracy instead of Iraqi oil for the corporatocracy.

D. Other Regions

Although there is a vast literature on political destabilisation and regime change in other natural resource-rich developing regions in the Middle East, Africa, Asia and Oceania and transitional countries in Eastern Europe, it is beyond the scope of this chapter to examine them.[76] The looting and exploitation of Africa is well documented by many

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[73] U.S. Crusade News, 'These Wars Are About Oil, Not Democracy' (23 June 2008), online at http://www.uscrusade.com/. <Accessed 24.06.08>.

[74] G.W. Bush, 'President Addresses the Nation in Prime Time Press Conference' (13 April 2004) online at http://www.whitehouse.gov/news/releases/2004/0420040413-02.html. Quoted in David Harvey, 'Neo-liberalism and the Restoration of Class Power' online at http://www.princeton.edu/~sf/workshops/neoliberalism/classrestore.pdf. <Accessed 27.06.08>.

[75] The figures of Iraqi deaths could be more but according to one source, the figure as at 27 June 2008 is 1,225,898 as at 25 June 2008: see http://www.justforeignpolicy.org/iraq/iraqdeath.html. The number of US casualties is 4,106: see http://icasualties.org/oif/. The cost of war and occupation of Iraq is $531, 089, 948, 024: see http://www.nationalpriorities.org/costofwar_home. <Accessed 27.06.08>.

[76] Here, I list some of these materials. Chalmers Johnson, *The Sorrows of Empire: Militarism, Secrecy, and the End of the Republic* (2004); Clara Nieto, *Masters of War: Latin America and U.S. Aggression* (2003); Michel Chossudovsky, *The Globalization of Poverty and the New World Order* (2nd ed, 2003); Samantha Power, '*A Problem from Hell': America and the Age of Genocide* (2002); Al Franken, *Lies and the Lying Lies Who Tell Them: A Fair and Balanced Look at the Right* (2003); Thom Hartmann, *Unequal Protection: The Rise of Corporate Dominance and the Theft of Human Rights* (2002); John J. Mearsheimer, *The Tragedy of Great Power Politics* (2001); Walter Russel Mead, *Special Providence: American Foreign Policy and How It Changed the World* (2002); James Bamford, *Body of Secrets: Anatomy of the Ultra-Secret National Security Agency* (2001), especially pp.70-75; John Quigley, *The Ruses of War: American Interventionism Since World War II* (1992); Nancy Chang, *Silencing Political Dissent: How September 11 Anti-Terrorism Measures Threaten Our Civil Liberties* (2002); Austin Murphy, *The Triumph of Evil: The Reality of the USA's Cold War Victory* (2000); L. Fletcher Prouty,

researchers.[77] For example, Douglas A. Yates exposes 'how and why neocolonialism causes underdevelopment, dictatorship and general suffering for the average African who lives under it.'[78] He argues that while the 'patronage and protection of a neocolonial power does have its advantages (e.g. regime stability and financial aid), *the need to satisfy the interests of a neocolonial power places a heavy burden on its African subject*

The Secret Team (1973); Michael T. Klare, *Resource Wars: The New Landscape of Global Conflict* (2001); Michel Chossudovsky, *The Globalization of Poverty: Impacts of IMF and World Bank Reforms* (1997); William Blum, *Rogue States: A Guide to the World's Only Super Power* (2000); ------, *Killing Hope: U.S. Military Interventions Since World War II* (1995); ------, *The CIA: A Forgotten History* (1986) pp.127-128, 131, 185; Chalmers Johnson, *Blowback: The Cost and Consequences of American Empire* (2000); John Prados, *The President's Secret Wars* (1986); -------, *The President's Secret Wars: CIA and Pentagon Covert Operations form World War II Through the Persian Gulf War* (1996); Ted Gup, *The Book of Honor: Covert Lives and Classified Deaths at the CIA* (2000); K. Nair, *Devil and His Dart: How the CIA is Plotting in the Third World* (1986); Susanne Jonas, *The Battle for Guatemala: Rebels, Death Squads, and the U.S. Power (*1991).

[77] See for examples, Global Witness, 'Oil and Mining in Violent Places: Why Voluntary Codes for Companies Don't Guarantee Human Rights' (New York, October 2007); Ariel Cohen and Rafal Alasa, 'Africa's Oil and Gas Sector: Implications for U.S. Policy' (13 July 2007) *Backgrounder* No. 2052, published by the Heritage Foundation based at Washington D.C., USA. Cohen and Alasa argue a case for US corporatocracy to exploit African natural resources. Arvind Ganesan and Alex Vines, *Engine of War: Resources, Greed, and the Predatory State* online at http://www.hrw.org/wr2k4/download/14.pdf. <Accessed 27.06.08>; Christian Dietrich, 'Hard Currency: The Criminalized Diamond Economy of the Democratic Republic of the Congo and its Neighbours' (Occasional Paper No.4, Partnership Africa Canada, Ottawa, June 2002); Oxfam America, 'Hidden Treasure? In Search of Mali's Gold-Mining Revenues' (Boston, MA, 2006); Raymond Dumett, 'Africa's Strategic Minerals During the Second World War' (1985) 26 (4) *The Journal of African History* pp.381-408; Louis Goreux, 'Conflict Diamonds' (Africa Region Working Paper Series No. 13, The World Bank, Washington D.C., March 2001); Global Witness, 'The Truth About Diamonds' (New York, November 2006); ------, 'A Crude Awakening: The Role of the Oil and Banking Industries in Angola's Civil War and the Plunder of Africa's Assets' (London: undated) online at http://globalpolicy.igc.org/security/sanction/angola/1999/crude.pdf. <Accessed 27.06.08>; -----, 'The Devastating Story of Oil and Banking in Angola's Privatised War: 'All the President's Men' (Global Witness, London, March 2002); -------, 'Time for Transparency: Coming Clean on Oil, Mining and Gas Revenues' (Global Witness, Washington D.C., March 2004); -------, 'Heavy Mittal? A State Within a State: The Inequitable Mineral Development Agreement between the Government of Liberia and Mittal Steel Holdings NV' (Washington D.C., October 2006); ------, 'Timber, Taylor, Soldier, Spy: How Liberia's Uncontrolled Resource Exploitation, Charles Taylor's Manipulation and the Re-recruitment of Ex-Combatants are Threatening Regional Peace' (Report submitted to the UN Security Council, June 2005); Human Rights Watch, 'Some Transparency, No Accountability: The Use of Oil Revenue in Angola and Its Impact on Human Rights' (January 2004) Vol. 16, No.1 (A), *Human Rights Watch* pp.1-93; Marina Ottaway, 'Reluctant Missionaries' (2001) 125 *Foreign Policy* pp.44-54; Raphael Fisera, *A People vs. Corporations? Self-determination, Natural Resources and Transnational Corporations in Western Sahara* (Thesis written in the framework of the European Master's degree in Human Rights and Democratisation at the European Inter-University Centre for Human Rights and Democratisation in Venice, Italty and the University of Deusto in Bilbao, Spain in the academic year 2003/2004).

[78] Douglas A. Yates, *The Rentier State in Africa: Oil Dependency and Neocolonialism in the Republic of Gabon* (1996) p.8.

society – in some cases destroying the very foundations of economic and political development.'[79]

Transitional and newly emerging nation-states such as Kazakhstan, Turkmenistan, Russia,[80] as well as much of Asia are similarly plundered by the corporatocracy.[81] American presence in Afghanistan and the transitional states in central Asia like Georgia, is telling. '*The goal is to control, through vassals, of former Soviet Central Asia, a region rich in oil and minerals and of great strategic importance to competing powers, Russia and China. By February 2002, the United States had established permanent military bases in all the Central Asian republics….*'[82] According to some sources, the assassination of Bhutto in Pakistan and the overthrow of Thailand's Prime Minister Thaksin were also caused by the corporatocracy for refusing to cooperate with them.[83]

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79 Ibid. Italics original.

80 For Turkmenistan, see Global Witness, 'It's a Gas: Funny Business in the Turkmenistan-Ukraine Gas Trade' (Washington D.C., April 2006). For Kazakhstan, see Global Witness, 'Time for Transparency: Coming Clean on Oil, Mining and Gas Revenues' (Washington D.C., March 2004); For Russia, see Dmitry Gololobav, *The Yukos Money Laundering Case: A Never-ending Story* (6 January 2008), a paper online at http://students.law.umich.edu/mjil/article-pdfs/v28n4-gololobov.pdf. <Accessed 27.06.08>.

81 In the case of Asia, see Indonesia as an example: 'Indonesia: Support Needed for Return and Re-Integration of Displaced Acehnese Following Peace Agreement' (A profile of the internal displacement situation, dated 19 July 2006, by Internal Displacement Monitoring Centre (IDMC)); 'Golden Rules: Making the Case for Responsible Mining' (Report by Earthworks and Oxfam America, 2007), online at http://www.oxfamamerica.org; Asian and Indigenous Tribal Peoples Network, 'Indonesia: Piecemeal Approaches to Systemic and Institutionalised Discrimination: A Shadow Report to the Initial Third Periodic Reports to the CERD Committee' (Janakpuri, New Delhi, August 2007). The removal of General Sukarno and installation of General Suharto, the support for President Marcos of the Philippines, and the Vietnam War are obvious examples.

82 John Pilger, *The New Rulers of the World* (2002) pp.104-105. Emphasis added.

83 On Thaksin's removal, see Walden Bello, *All Fall Down: The Asian Financial Crisis, Neoliberalism and Economic Miracles* posted online at Japan Focus, http://www.japanfocus.org/products/topdf/2486. <Accessed 16.06.08>. On Bhutto's assassination, see Moin Ansari, *The CIA Connection…Benazir Bhutto's Assassination was Pre-planned: The Zia Model with a Twist: The Great Game Continues: When the Elephants Dance the Grass gets Crushed: The Continued CIA Involvement in Pakistan* (6 January 2008) at http://rupeenews.com/2008/01/06/the-cia-connection%e2%80%a6-benazir-bhutto%e2%80%99s-assassination-was-pre-planned-the-zia-model-with-a-twistthe-continued-cia-involvement-in-pakistan-the-great-game-continues-when-the-elephants-d/. <Accessed 30.08.08>.

When colonial nations were declaring full independence after World War II, and hoping to emulate the West's economic success, the corporatocracy realized that this threatened their 'national security', meaning, continued exploitation of peripheral natural resources.[84] The corporatocracy therefore used overt and covert operations such as that of the CIA to fund and control sources of information including the media, research institutions, and universities to produce lies and propaganda to drum up fear about the spread of communism in these countries, and imminent threat of nuclear confrontation with the Soviet Union.[85] They then set up dictatorial regimes, which cooperated with them, and destabilized and removed nationalist and democratic leaders who refused to serve U.S. imperial interests. In the mass media, however, the public was misled to read these operations as being necessary to contain communism, and advance democracy and freedom, just as they have done to Iraq, Afghanistan, Yugoslavia and what they are doing now to Iran.[86]

II. LOOTING PERIPHERAL WEALTH BY 'BIG BANKS', 'BIG OIL', AND CORRUPT RULING ELITES

There are other ways of causing and maintaining underdevelopment of the resource-rich periphery. In this section we will look at three case examples: how corrupt local elites and transnational corporations combine to loot nature's wealth as in Nigeria; using corporations to maintain neocolonialism as revealed in the French Elf scandal, and how big banks use despotic regimes to launder money as in the case of Chile.

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84 Smith, above n1, at p.69.

85 For details on this see Frances Stoner Saunders, *The Cultural Cold War: The CIA and the World of Arts and Letters* (1999).

86 Smith, above n1 at p.69.

A. Nigeria

Nigeria, Africa's largest oil producer, ranking eighth in the world, producing about 2.4 million barrels per day, accounting for 95 percent of the country's foreign exchange earnings, and which earned about US$450 billion between 1974 and 2004, has 75 percent of its 130 million people living on less than US$1.00 per day.[87] What happened to the oil wealth? Many studies have been done to address this question.[88] The short answer from these studies is that the local ruling elites and transnational oil corporations share the oil bonanza, denying the vast majority their fair share in the form of delivery of social goods and services such as health, education and infrastructure. Servicing odious debts and corruption are the two chief causes of Nigeria's poverty and underdevelopment.

Let us take a closer look at loans and debt service first. Since independence from Great Britain in 1960 to 1977 Nigeria's external debts were about $762.9 million and thus manageable.[89] However, during the regime of the military dictator General Olusengun Obasanjo (1976-1979) the country's debt leapfrogged into the billions, to about $2.164 billion in 1978.[90] Obasanjo departed from the tradition of borrowing only from multilateral/bilateral institutions to sourcing loans on the open international financial market. The latter sources charged higher interest rates and had shorter maturity date and repayment period. By the time Obasanjo stood down, he had taken additional loans when

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87 Sarah Ahmed Khan, *Nigeria: The Political Economy of Oil* (1994) p.189; Tom Forrest, *Politics and Economic Development in Nigeria* (1995) p.133.

88 Subcommittee on Africa, Global Human Rights and International Operations of the Committee on International Relations House of Representatives 109 Congress, 2nd Session, 18 May 2006, Serial No. 109-172 (Washington, D.C.: US Government Printing Office, 2006). This is one of the latest and most comprehensive report available at http://foreignaffairs.house.gov/archives/109/27648.PDF. <Accessed 09.02.09>; Julian Morris (ed), *Sustainable Development: Promoting Progress or Perpetuating Poverty?* (2002); Lacqueline Coolidge and Susan Rose-Ackerman, 'High-Level Rent Seeking and Corruption in African Regimes: Theory and Cases' (Washington D.C.: The World Bank Group, 1995); Godfrey Mwakikagile, *Africa is in a Mess: What Went Wrong and What Should Be Done?* (2004).

89 African Forum Network on Debt and Development (AFRODAD), *Nigeria: Foreign Debts, Stolen Wealth, IFIs and the West: A Case Study* (2007) p.10.

90 Ibid.

the first loans became due, and handed power over to a corrupt civilian regime headed by President Shehu Shagari (1979-1982). Since then the debts have climbed to $29.282 billion in 1988, and reached $35.6 billion by 2005.[91]

Of these debts, $35 billion was owed to the Paris Club group of creditors comprising 14 Western countries plus Japan, which amounted to about 75.26 percent of Nigeria's total external debt. This has been forgiven through the debt relief program in 2005. The remaining 24.74 percent comprise multilateral debts ($2.70 billion), and non-Paris club debts divided among bilateral debts ($121.04 million), London Club debts ($1.44 billion) and Promissory Notes (580.49 million).[92] Although the military rulers, Generals Muhammedu Buhari and Sani Abacha borrowed no foreign loans, Abacha refused to service the loans, so accrued penalties and interests consequently increased the debt to about $26.6 billion.

On the second issue, tables 9.1 and 9.2 list some evidence of how Nigerian elites and transnational corporations looted Nigeria's oil wealth.[93] Owolabi Bakre estimates that more than US$600 billion oil wealth has disappeared from Nigeria over the past 40 years.[94] By 2008, an estimated US$170 billion was staked away in private bank accounts in some 'anti-corruption and anti-money laundering-preaching Western nations'.[95]

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91 Id., at p.11. See also George B. N. Ayittey, 'Nigeria's Struggle with Corruption' (Paper delivered as a Testimony before the Committee on International Relations' Subcommittee on Africa, Global Human Rights and International Operations House Sub-Committee on Africa, US House of Representatives, Washington D.C., Thursday, 18 May 2006).

92 AFRODAD, above n89, at p.12.

93 Owolabi M. Bakre, 'Looting By the Ruling Elites, Multinational Corporations and the Accountants: The Genesis of Indebtedness, Poverty and Underdevelopment of Nigeria' (University of Essex, Colchester, UK: School of Accounting, Finance and Management, 03 July 2008).

94 Paul Wolfowitz, president of the World Bank, estimates it to be US$300 billion: see *Nigeria Badly Raped – World Bank* online at http://againstbabangida.com/index2.php?option=com_content&do_pdf=1&id=271. <Accessed 08.02.09>.

95 Ibid.

Bakre observes that to control corruption, Nigeria must adopt effective legislation that prosecutes the erring local political and bureaucratic elites, and the multinational corporations, and revamp the professional practice and misconduct rules of accountants.[96]

Table 9.1

Part Played by Corrupt Local Elites

- President Obasanjo (1999-2007) took US$14.4 billion.
- Babangida squandered over US$30 billion.
- President Abacha and his family looted over US$36 billion.
- US$4 billion disappeared when Buhari was petroleum Minister.
- Abubakar collected US$86 million contract fees, without execution.
- No Investigation or prosecution of any of these looters so far.

Accountants' Connection

- Michael Ani, accountant and partner at Ani, Ogunde & Co and a fellow of the Institute of Chartered Accountants of Nigeria used his professional expertise to aid Abacha's son to launder US$2 billion.
- Auditor-General and accountants implicated in a 2006 investigation led to the recovery of about US$19.7 million.
- US$452,250 recovered from the office of the Auditor-General.
- Accountants at the Ministry of Health suspended for looting US$2.1 million in unspent budget of the Ministry.
- Auditor-General who has indicted politicians on US$1.3 million expenditure, has himself been dragged to Court by the Independent Corrupt Practices and Other Related Offences Commission (ICPC) for allegedly stopping the ICPC operatives from scrutinising the account books of his office.
- PriceWaterHouse Coopers provided favourable certification and misleading financial statement of Chevron Nigeria Ltd contrary to s 23 (1) of the Nigerian *Accounting Standards Board* (NASB) *Act No 22* of 2003.
- Inspector of NASB imposed a penalty of US$41,250 on Chevron and its managing director and demanded that necessary revisions be made to the misleading financial statements within 60 days.
- Chevron refused to pay the US$41,250 or restate misleading financial statements within the given 60 days.

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[96] Ibid.

Table 9.2

Part Played by Royal Dutch Shell

- US$1.9 billion due from controversial production-sharing contracts.
- Collaborated with Petroleum Minister, Edmund Dakouru, to avoid paying tax totalling US$3.2 billion in 2006.
- Collaborated with IGP, Ibrahim Commassie and a Nigerian merchant of Death, Chief Akinluyi, to import ammunition to Nigeria in contravention of the Nigerian Constitution and law.
- Implicated inUS$6 million Wilbros bribery scandal.
- Linked with the killing of about 29 people in the Niger Delta.

Part Played by Exxon Mobil

- US$1 billion due from controversial production sharing contracts.
- Ignored criminal summons to pay US$27 million tax due to Akwa Ibom State Government for about 15 years.
- Mobil admits to several oil spills in the Niger Delta, but despite intervention by the Nigerian Parliament and court rulings in favour of the victims, Mobil refuses to pay US$295 million; US$73.6 million and US$9.8 million compensation to its victims as ordered.

Part Played by Chevron Nigeria Limited

- Diverted US$75 million government tax through dividends.
- Evaded US$190 million tax liability based on fictitious capital allowance claim.
- Evaded US$222 million tax through claims to unmerited tax credits, such as Reserve Additional Bonus (RAB) and Intangible Drilling Cost (IDC).
- Conspired with Nigerian tax officials to lower tax assessment than the expected US$96 million.
- Alleged money laundering to the tune of US$260 million.
- Found guilty of killing Nigerians for oil by a Court in the USA.

Part Played by Other Multinationals

- All the oil companies currently owe about US$272 million to the Niger Delta Development Commission (NDDC).
- US$500 million defrauded by foreign airline companies, particularly the Germany-based Lufthansa, through non-registration with the Corporate Affairs Commission.
- Bristow Helicopter bribed Nigerian tax officials to the tune of US$423,000 in exchange for reduced employment taxes.

The part played by foreign ‘big banks’ is revealed by a number of reports; for examples, a 2005 report of the United States *Senate Permanent Subcommittee on Investigations of the Committee on Homeland Security and Government Affairs* (SPS Report),[97] a 2006

[97] United States Senate, Permanent Subcommittee on Investigations, Committee on Homeland Security and Government Affairs, *Money Laundering and Foreign Corruption: Enforcement and Effectiveness of the Patriot Act: Supplemental Staff Report on U.S. Accounts Used by Augusto Pinochet*, 16 March 2005. Available online at http://hsgac.senate.gov/files/PINOCHETREPORTFINALwcharts0.pdf. <Accessed 09.02.09>.

report by Lucy Komisar of *Tax Justice Network* (TJN)[98] and the *Legal Remedies Report* of the Open Society Institute of New York mentioned in Chapter Seven.[99] According to the SPS and the TJN reports, Citigroup is in the forefront in operating secret bank accounts for very wealthy clients with $5 million minimum and generally more than $10 million in deposits. Citigroup was responsible for setting up three special bank accounts under pseudonyms for the three sons of Nigeria's dictator Sani Abacha from 1993 until his death in 1998. Law enforcement authorities in the U.S. could not enforce the law against Citigroup because both sides of U.S. politics from Ronald Reagan and George Bush Sr. to Bill Clinton and George Bush Jr. had close relationships with the big banks and big oil.

Apart from Citigroup, other big banks like HSBC, BNP Paribas, Credit Suisse, Standard Chartered and Deutsche Morgan Grenfell also assisted Nigeria's dictatorial regimes to loot the country's oil money into their coffers. 'When Sani Abacha was dictator of Nigeria, the Central Bank had a standing order instruction to transfer US$15 million or so to his Swiss bank account everyday.'[100] Public records show that Sani Abacha is 'the undisputed king of Nigerian thieves' and 'that there was a vast conspiracy by some powerful multinational companies to defraud Nigeria.'[101]

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[98] Lucy Komisar, 'Citigroup: A Culture and History of Tax Evasion' (Tax Justice Network, New York January 2006).

[99] *Legal Remedies for the Resource Curse: A Digest of Experience in Using Law to Combat Natural Resource Corruption*, see Ch.7., p.26.

[100] *The Economist*, quoted in Tax Justice Network for Africa, *Looting Africa: Some Facts and Figures* (undated and online at http://www.liberationafrique.org/IMG/pdf/TJN4Africa.pdf. <Accessed 09.02.09>.

[101] Chike E. Okafo, *Looting of Nigeria's Treasury: Who Else is Involved Besides Abacha Family?* online at http://www.nigerdeltacongress.com/karticles/looting_of_nigerian_treasury.htm. <Accessed 09.02.09>.

Big banks have saddled Nigeria with odious debts and demanded every cent to be repaid with interests and penalties. Big banks financed big oil to extract Nigeria's oil resources. Big oil evaded their tax obligations, refused to uphold the rule of law and observe court orders as shown in the tables above. Big banks opened secret accounts for the corrupt civilian and dictatorial military rulers, and big oil deposited oil money into those accounts. In the name of relieving the country from the debt-related economic crisis, multilateral agencies like the IMF and the World Bank imposed structural adjustment programs (SAPs), giving free reign to the powerful transnational corporations and the corrupt and dictatorial rulers to further plunder the wealth of Nigerians. Consequently, the Nigerian population suffered and continues to suffer.[102] Okafo captures the plight of Nigerians as follows:

> These MNC are not contented with the mineral exploitation and slave labor of the indigenes, but also were interested in a total control of Nigerian economy. They were not satisfied with the vast monopoly they enjoy in mineral extraction, exportation and marketing, but also in exportation of the little profit that is given to the Nigerian government for allowing them to share Nigerian mineral wealth. Instead of confining themselves to the full utilization of their technological advantage in the mineral production, they have conspired with our self-anointed parasitic leaders to export whatever money the country derived from the mineral wealth. They have used the Nigerian sweat and blood to create boisterous economies in their countries and in return, have insisted through the World Bank and IMF that Nigerian government penalizes its citizens through austerity measures. The measures that they advocate were supposed to keep the citizen from knowing what is going on and to cast them into perpetual poverty...[103]

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[102] See Agwara John Onyeukwu, 'Resource Curse in Nigeria: Perception and Challenges' (Central European University Centre for Policy Studies, Open Society Institute, Budapest, 2007).

[103] Okafo, above n101.

B. Elf Aquitaine's Bribery Case.

Elf Aquitaine, France's national oil company before its merger with Total and Fina in 1994 was not only France's largest company, but also '*an extension of the country's foreign-policy machine*.'[104] Indeed, it was through Elf that 'French influence and involvement in the affairs of the [African] continent remain far more significant than those of other former colonial powers.'[105] According to Global Witness: '*More than any other oil company in Africa, France's Elf has for years played the game of African politics not only to win control over coveted oil licences, but as an arm of French diplomacy and intelligence. It has come to typify dubious multinational company activities in Africa – mixing politics with corporate gain*.'[106] 'Elf…used French political influence to sign favourable contracts in countries such as Gabon, Angola, Cameroon, and Congo-Brazzaville. Bribes also allegedly went to politicians in those countries.'[107]

In 1994, Eva Joly, a French magistrate began investigating these bribery and corruption allegations against Elf. His investigations eventually revealed massive financial kickbacks to French politicians through the siphoning off of proceeds from Elf's contracts in Africa, South America, Russia, Spain and Germany between 1989 and 1993. After 8 years of investigation, 37 people, including 27 Elf officials were put on trial in France in 2003 for 'misusing company assets' because there was nothing illegal under French law about the $346.8 million used as bribes to secure contracts in Africa, Latin

[104] Deutsche Welle, *Managers Sentenced to Jail in Elf Corruption Trial*, at http://www.dw-world.de/popups/popup_printcontent/0,,1028135,00... <Accessed 16.10.07>. Emphasis added.
[105] Daniel Bach, 'France's Involvement in Sub-Saharan Africa: A Necessary Condition to Middle Power Status in the International System', in A. Sesay (ed), *Africa and Europe* (1986) p.75.
[106] Global Witness, 'A Crude Awakening…,' above n77, at p.10. Emphasis added.
[107] The Legal Remedies Report, above n99, at p.23.

America and Europe.[108] After a four-month trial, 30 Elf officials have been convicted and sentenced to jail. Loik Le Floch Prigen, the former chief executive of the company, and Alfred Sirven, his deputy, each received a five-year jail sentence. Andre Tarallo, a former regional director for Africa, received a four-year jail sentence. In welcoming the sentences, Transparency International remarked: 'The outcome of the Elf case sends a strong message. The sentences have shaken large-scale corruption to its very core, removing the peace of mind and impunity leaders and high ranking officials quietly enjoyed. It also cast special light on the extent and negative impact of nepotism and favouritism in political relations between France and some African countries.'[109]

The Elf scandal, dubbed as the largest corruption case in French's history, increased public awareness and revealed the nature of corporate corruption involving governments in the developed North and the developing South. The Elf investigation also exposed the corrupt activities of the U.S. giant Halliburton, the world's largest leading provider of oil and gas production support services, and three other multinational construction companies alleged to be involved in bribing Nigerian federal government officials to win bids for the construction of a liquefied natural gas plant. One of the witnesses of the Elf case testified that the consortium maintained a 'slush fund' worth $180 million to bribe Nigerian officials. A revealing chronology of Halliburton and its involvement in this bribery allegation provided by *Halliburton Watch*[110] exposes the extent of the case. Halliburton indeed admitted in 2006 that its minutes of internal meetings show the

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[108] Ibid. See also Media Library Press Release, online at http://www.globalwitness.org/media_library_detail.php/285/en/elf_trial_throws_spotlight_on_oil_and_corruption. <Accessed 16.10.07>.

[109] Muzong Kodi, Transparency International Director for Africa and the Middle East, *The Elf Tria: A Victory Over Impunity* online at http://transparency.org/layout/set/print/news_room/latest_news/pres... <Accessed 16.10.07>.

[110] *Halliburton Watch*, at http://www.halliburtonwatch.org/about_hal/nigeria_timeline.html. <Accessed 17.10.07>.

consortium had 'considered payments to Nigerian officials.'[111] These cases demonstrate that corruption and bribery of government officials in developing countries by multinational corporations undermine the rule of law and weaken institutions.

C. Big Banks and the Other Side of the Neoliberal Success Story of Chile

Since the terrorists attack in New York on 11 September 2001 (9/11), the U.S. government, through its *Senate Permanent Subcommittee on Investigations* of the *Committee on Homeland Security and Government Affairs* has sought to enforce the *Patriot Act* 2001 by conducting investigations into money laundering by private banking, correspondent banking and securities industries. The *Patriot Act* obliges U.S. financial institutions to exercise due diligence when opening and administering accounts for foreign political figures, and proven corrupt acts by foreign officials as an allowable basis for U.S. money laundering prosecutions. The *Senate Permanent Subcommittee Report* (Senate Report) released its preliminary findings in July 2004 and a supplementary report in March 2005.[112] Both reports expose the vast network of secret private bank accounts in the U.S. and elsewhere held by Augusto Pinochet, his family members and close associates, and his shell companies since he took office in a military coup in 1973 and served as Chile's President until 1990, and then as Commander-in-Chief of the Chilean army until 1998, and thereafter as 'Senator for Life' after he stood down from the army.

The Senate Reports reveal that big banks in the U.S., U.K., Spain and elsewhere have solicited and assisted Pinochet to loot Chile's wealth by creating several secret accounts under pseudonyms, facilitating inter-bank transfers to evade legal sanctions against his

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[111] Michael Peel, *The Financial Times UK* (7 August 2006) online at http://www.truthout.org/cgi-bin/artman/exec/view.cgi/63/21700. <Accessed 17.10.07>.

[112] United States Senate, 'Money Laundering and Foreign Corruption: Enforcement and Effectiveness of the Patriot Act – Case Study Involving Riggs Bank' (US Senate Report, Washington D.C., July 2004). The 2005 report is cited above, n97.

accounts and refusing to disclose the details of his accounts to law enforcement authorities. The 2005 Report reveals that Pinochet had a 25-year relationship with Riggs bank, a U.S. bank based in Washington D.C., in which he held 28 accounts.[113] In the 8 accounts found by the 2004 Report, Pinochet's deposits at Riggs varied from $4 million to $8 million, held in several personal and corporate names.[114] The two reports reveal that Riggs senior officials played significant roles to solicit business from the Chilean military regime since the 1990s. In fact, a senior delegation from Riggs travelled to South America in 1996 to solicit business, especially to ask Pinochet to open an account with Riggs. A Riggs subsidiary in the Bahamas then established two companies, Ashburton Co. Ltd. and Althorp Investment Co. Ltd., both putatively owned by trusts set up by Riggs. Pinochet's funds were deposited into these trusts, among others.

Other banks that facilitated Pinochet to launder Chilean wealth include Citigroup, Banco de Chile-United States, Espirito Santo Bank of Florida, Banco Atlantico (part of the Banco de Sabadell), Bank of America, Coutts & Co. (USA) International (now part of Banco Santander), Ocean Bank in Miami, and PineBank N.A. also in Miami. According to the 2005 report: 'Evidence exists of still additional U.S. accounts related to Mr. Pinochet, but limited Subcommittee resources prevent an exhaustive analysis of all of the U.S. accounts used to assist Mr. Pinochet.'[115]

In July 1996, Pinochet was indicted by Spain on charges of genocide, terrorism and torture against Spanish citizens during his rule.[116] Lawyers in Spain representing the

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113 Because Riggs bank refused to cooperate, the 2004 Senate Report found only 9 accounts and 8-year relationship.

114 The US Senate Report (2004), above n112, at p.19.

115 2005 Senate Report, above n97, at p.5.

116 US Senate Report (2004) above n112, at p.20. It is well known that Pinochet was involved in corruption, illegal arms and drug trafficking, and the disappearance or murder of thousands of political

torture victims of Pinochet petitioned a Spanish judge to add directors and officers of Riggs as targets in his long-running investigation. They argued that Riggs was concealing the bank accounts of the former Chilean dictator. In September 2004, the investigating judge allowed the petitioning torture victims to bring complaints against seven current and former directors and employees of Riggs as defendants for the alleged concealment of Pinochet's assets and money-laundering activities. In February 2005, the petitioners and Riggs entered into a settlement agreement under which Riggs agreed to pay US$8 million and provide the plaintiffs with information. Consequently, the judge dismissed all criminal claims against Riggs former and current directors and officers as well as civil claims against the bank.

Meanwhile, in the U.S. Riggs was charged and it pleaded guilty to a federal criminal violation of the *Bank Secrecy Act* of 1970 for failing to accurately report suspicious monetary transactions associated with bank accounts owned and controlled by Pinochet and the dictatorial ruler of Equatorial Guinea. Riggs was fined $25 million for its failure to report suspicious transaction in the Equatorial Guinean accounts, making it the largest fine ever. For its dealings with Pinochet, Riggs was sentenced to a $16 million criminal fine in April 2005. The federal judge involved in that cased described the bank as '*a greedy corporate henchman of dictators and their corrupt regimes*.'[117]

opponents during his reign from 1973 to 1990: see Terence O'Hara and Kathleen Day, 'Riggs Bank Hid Assets of Pinochet, Report Says', *The Washington Post*, Thursday, 15 July 2004, p.A01, online at http://www.washingtonpost.com/wp-dyn/articles/A50222-2004Jul14.html. <Accessed 17.10.07>. Meanwhile, the court found that Pinochet was unfit to be extradited to stand trial in Spain in 2000 and was thus allowed to return to Chile. Other countries including the United Kingdom, Argentina, Belgium, France and Switzerland also charged Pinochet, but in each case he had been found by the presiding court to be unavailable, unfit, or immune to prosecution.

[117] Quoted in the Legal Remedies Report, above n97, at p.34. Emphasis added.

Without the attention of the Spanish courts, the U.S. Senate and the press, one wonders whether even this limited success in enforcement of the law would have been achieved. In any case, one also wonders whether Riggs was adequately punished since it was acquired by PN Financial Services Group Inc. in May 2005, and continues to do business as usual under a new name and management.

D. 'Bank of Crooks and Criminal International'.

Like Riggs, one of the most explosive examples of big banks, big oil, drug lords, jihad terrorists, and powerful political elites who combine to plunder and loot peripheral treasures relates to the secretive operations of the Bank of Credit and Commerce International (BCCI), described by the former CIA director Robert Gates as the 'Bank of Crooks and Criminal International'.[118] Indeed, many studies reveal that from Saudi Arabia to South America and from Pakistan to Paris, and to other major centers of world capitalism, BCCI was able to connect the Bush family with the Bin Laden family and Saddam Hussein to secret offshore accounts owned and operated by the big banks.[119]

The case of BCCI is not an isolated matter. Other major international banks follow similar strategies. An investigation by *Global Witness* of the banks and international financial institutions, which mortgaged Angola's future oil revenue, yet again provides

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[118] Lucy Komisar, 'BCCI's Double Game: Banking on America, Banking on Jihad', in Hiatt (ed), above n56, pp.97-217. Gates was Defence Secretary under Bush and Obama has retained him in that position.

[119] For details read M. Johnston, *Syndromes of Corruption: Wealth, Power and Democracy* (2005); Alan A. Block (ed), *The Organized Criminal Activities of the Bank of Credit and Commerce International: Essays and Documentation: In memoriam David Whitby*, (2001); Jonathan Beatty and S. C. Gwynne, *The Outlaw Bank: A Wild Ride into the Secret Heart of BCCI* (2004); James Ring Adams and Douglas Frantz, *A Full Service Bank: How BCCI Stole Billions around the World* (1992); Peter Truell and Larry Gurwin, *False Profits* (1992); Senator John Kerry and Senator Hank Brown, 'The BCCI Affair: A Report to the Committee on Foreign Relations, United States Senate' (December 1992, 102nd Congress, 2nd Session, Senate).

one example.[120] Global Witness claims that oil-backed loans represent a vast source of unaccountable income to the Angolan government in addition to the oil revenues. Its investigations uncovered that, of the more than $3.55 billion the Angolan Government borrowed by mortgaging future oil production at high interest rates between September 2000 to October 2001 alone, the financial institutions which provided these loans helped shift about US$ 1.4 billion to hidden offshore accounts.[121] Global Witness observes that this is not an isolated case but a pattern that affects other resource-rich African countries.[122] In a December 2005 report, *Global Witness* reveals that oil-mortgaged external indebtedness to the Republic of Congo is US$8.35 billion, making it one of the highest in the world.[123] These oil-rich developing countries are lured by big banks with their loans and trapped in debt in order to siphon off their oil revenues. Local ruling elites happily participate because they too stand to benefit from the loot, while their countries and people suffer.

III. CONCLUSION

First, this chapter establishes that the immense inequality in economic power that exists in the world capitalist system translates into a formidable inequality of political power, which coerces developing countries to serve the interests of the corporatocracy. The undisputed result is *underdevelopment* or the *resource curse* – depending on whichever ideological standpoint one takes. An online view of the International Law Association provides a succinct summary on this point as follows:

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[120] Global Witness, *All the President's Men…*, above n77, at p.4.
[121] Ibid.
[122] Id., at p.6.
[123] Global Witness, *The Riddle of the Sphynx: Where Has Congo's Oil Money Gone?* online at http://osisa.org/files/transparency_cd/global%20witness/The_Riddle_of_the_Sphynx.pdf. <Accessed 27.06.08>.

> In Latin America the poor still struggle against the yoke of multinational enterprises plundering the whole continent, the destruction of the environment and a life in utmost misery. But also Africa remains nothing but a toy in the hands of post-colonial imperialists who fan the flames of war between the poor, let whole populations starve and die from diseases in order to rob a whole continent of its natural resources.[124]

Second, this chapter demonstrates that institutional weaknesses, lack of transparency, and bad governance are not only caused by domestic sources as the RCT portrays. In fact, transnational corporate interests as well as the interests of rich and powerful governments affect institutions in developing countries. Stealth corporations and their secret offshore accounts play a large part. Large corporations even undermine local institutions, the rule of law, and good governance principles, even disobeying court orders, as the Nigerian cases show.

Third, this chapter establishes that transnational corporations in the extractive industries are not there to help developing countries grow and develop, but cause developing countries to transfer natural resource wealth into their opaque offshore accounts to accumulate, consolidate and concentrate wealth for further accumulation.

Finally, when nationalist leaders arise to 'break free' from the bond of neocolonialism and imperialism, the good institutions, good governance and transparency-preaching governments of the rich and industrialised countries sent in their jackals and military to remove such leaders and stir up internal turmoil to cause regime change. This is to say that the economic independence of a resource-rich developing country is a threat to the 'national interest' of the imperial nations like the U.S. and its allies. The case of Iraq and

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[124] International Law Association, *Against the State and Capitalism: In Memory of the Haymarket Martyrs* online at http://iwa-ait.org/mayday08-en.html. <Accessed 26.06.08>.

Iran, which sought to break free from the U.S. dollar hegemony, and the case of Venezuela, which challenges the Monroe doctrine, reinforce this point. As the case of Chile and Nigeria demonstrate, good institutions, transparency and good governance or democracy is not demanded of dictatorial rulers and mass murderers for so long as they serve the interests of the imperial and neocolonial powers. In my view, such 'good sounding' principles are employed as ideological instruments to divert attention away from the real causes of poverty and underdevelopment – the so-called resource curse.

CHAPTER TEN

LEGAL CAUSES OF THE RESOURCE CURSE IN PAPUA NEW GUINEA

INTRODUCTION

According to the legal causes and explanations of the resource curse thesis (RCT) examined in Chapter Three the type of mineral and petroleum ownership regime in a developing country chooses affects its economic growth and social progress. Of the four ownership regime types, which are (1) *State ownership with control*, (2) *State ownership without control*, (3) *private domestic ownership*, and (4) *private foreign ownership*, Luong and Weinthal found that *private domestic ownership* does not cause the resource curse. After arriving at this conclusion, Luong and Weinthal then asked:

> If private domestic ownership offers a way for mineral-rich states to escape the alleged curse of their wealth, why has this form of ownership structure been so rare for the past century? Conversely, why did private foreign ownership predominate during the first half of the twentieth century, and why did state ownership with and without foreign control predominate during the second half?[1]

Luong and Weinthal did not answer this question. They merely conjectured that it could be caused by international factors, namely, the structure of international oil markets and policy convergence. This thesis has, however, argued that the international factors are colonialism, neocolonialism, imperialism and globalization of 'free market' capitalism or simply put 'neoliberalization'.

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[1] Pauline Jones Luong and Erika Weinthal, 'Rethinking the Resource Curse: Ownership Structure, Institutional Capacity, and Domestic Constraints' (2006) 9 *Annual Review of Political Science* pp.241-263, at p.254.

The purpose of this chapter is to support and extend this argument by demonstrating how the mineral and petroleum ownership regime Papua New Guinea (PNG) inherited from the Australian colonial government causes PNG's resource curse or underdevelopment. To pursue this argument, section I outlines the type of ownership regime PNG has today. Section II traces the colonial legal history on mineral and petroleum ownership. Section III examines the colonial justification for State ownership of minerals and petroleum. Section IV provides a conclusion.

I. MINERAL AND PETROLEUM OWNERSHIP REGIME TYPE IN PNG

Section 5 (1) of Papua New Guinea's *Mining Act 1992* provides: '*All minerals existing on, in or below the surface of any land in Papua New Guinea, including any minerals contained in any water lying on any land in Papua New Guinea, are the property of the State*.' Similarly, 6 (1) of Papua New Guinea's *Oil and Gas Act 1998* provides that '*notwithstanding anything contained in any other law or in any grant, instrument of title or other document, all petroleum and helium at or below the surface of any land is, and shall be deemed at all times to have been, the property of the State*.' (Emphasis added).

What type of ownership regime do these provisions represent? There is no doubt that these provisions reflect the PNG nation-state's assertion of political dominium over mineral and petroleum resources. The question here, however, focuses on the *ownership of shares and control* over mining and petroleum projects in PNG. According to the four regime types that Luong and Weinthal discuss, the key words are *ownership with* or

without control. It is useful to restate the four ownership types to examine these key words. The four ownership regime types are:

Table 10.1

- *State ownership with control*. The state owns the rights to develop mineral deposits and holds the majority of shares (51% +) in production, refining and/or export facilities. Foreign involvement in the mineral sector is limited either to participating in contracts that restrict their managerial and operational control, such as carried interest or joint ventures, or to operating as service subcontractors.
- *State ownership without control*. The state owns the rights to develop mineral deposits and holds the majority of shares (51% +) in production, refining, and/or export facilities. Foreign investors are allowed to participate through more permissive contracts, such as production-sharing agreements (PSAs), which grant them significant managerial and operational control.
- *Private domestic ownership*. Private domestic companies own the rights to develop mineral deposits and hold the majority of shares (51% +) in production, refining, and/or export facilities.
- *Private foreign ownership*. Private foreign companies own the rights to develop mineral deposits and hold the majority of shares (51% +) in production, refining, and/or export facilities.

To answer the above question within the context of these four types of ownership regimes, we need to look at *majority share ownership*, that is, *51 percent or more*, and *control* over mining and petroleum exploration, production, refining and export facilities in PNG. According to law and policy, the PNG government has an elective right to acquire a maximum of up to 30 percent in large mining projects, and 22.5 percent in petroleum projects, which are far below the 51 percent threshold in the ownership models above.[2]

[2] Section 165, *Oil and Gas Act 1998*.

In the Bougainville Copper Mine, before its forced closure in 1989, the PNG government had 19.1 percent shares instead of 30, Conzinc Riotinto of Australia (CRA) had 53.6 percent, and the public (mostly Australians) had 23.7 percent.[3] The Lihir Gold Limited is a publicly-traded company whose 20 largest shareholders comprise all foreign corporations except Mineral Resources Lihir Limited owned by the Lihir Island landowners and the New Ireland Provincial Government, which hold 0.42 percent of ordinary issued shares.[4] The PNG government has no equity in the project since its interest, held by Orogen Minerals Limited, was privatized in 2002.

In the Ok Tedi Copper and Gold Project, BHP Billiton transferred its shares to Papua New Guinea Sustainable Development Program Limited (PNGSDP), a Singapore-based company, which now holds 52 percent, Inmet 18 percent, the PNG government 15 percent, the Western Provincial Government 12.5 percent, and landowners 2.5 percent, giving a total domestic shareholding of 30 percent. In the Porgera Gold Project, Barrick has 95 percent while the landowners and the Enga Provincial Government share the remaining 5 percent.

In the Kutubu Petroleum Project, Oil Search Limited has 60.5 percent, Ampolex and Merlin Pacific Oil Company share 14.52 percent, AGL 11.9 percent, Merlin Petroleum Company 6.78 percent, and the Kutubu landowners 6.75 percent. The PNG government privatised its shares in Orogen Minerals Limited in 2002. Oil Search bought Orogen and

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[3] Paul Quodling (1991), cited by Jerome Kevin Lemein Semos, *Natural Resources, Nasioi Society and the Colonial and Post-Colonial State in Papua New Guinea: The Mining and the Undermining of Resource Sovereignty and Resource Development in the Bougainville Copper Project 1963-1990* (D Phil Thesis, James Cook University, 1998) p.90.

[4] Lihir Gold Management Limited, 2008 Annual Report, p.118.

part of its purchase price was converted to 18 percent shares in that company from which the PNG government receives dividends. The table below provides a summary of the foregoing shareholding arrangements.

Table 10.2

Project	**Shares in Percentage**
Bougainville Copper Mine	
• PNG Government	19.1%
• Conzinc Riotinto of Australia (CRA)	53.5%
• General Public, mostly Australians	23.7%
Ok Tedi Mining Limited	
• PNG Government	15%
• Fly River Provincial Government	12.5%
• Ok Tedi Landowners	2%
• PNG Sustainable Dev. Corp.	52%
• Inmet	18%
Lihir Gold Limited	
• Publicly traded company	
• 20 largest shareholders are foreigners	
• PNG Government	0%
• Lihir landowners	0.42%
Porgera Gold Limited	
• Barrick	95%
• Porgera Landowners and Enga Prov. Gov't.	5%
Kutubu Petroleum Project	
• Oil Search Limited	60.5%
• Ampolex and Merlin Pacific Oil Co.	14.52%
• AGL	11.9%
• Merlin Petroleum Co.	6.78%
• Kutubu Landowners	6.75%

In the proposed Liquefied Natural Gas Project (LNGP) to be undertaken by a consortium of joint venturers led by ExxonMobil that is expected to commence production by 2013-2014 from natural gas fields in the Southern Highlands piped to a liquefaction processing

plant outside Port Moresby, the PNG government took up only 19.4 percent, which will be shared with 'affected' customary landowners, and 'affected' provincial and local-level governments.[5] The above shareholding arrangements, as well as shareholding arrangements in other mining and petroleum projects in PNG, show that both the PNG government and the PNG public have insignificant share ownership in the minerals and petroleum projects in the country.

In terms of control, almost all managerial controls are in the hands of foreigners, including the board of directors in the large mining and petroleum projects in the country. A few Papua New Guineans have been appointed as directors and to managerial positions by some of the mining and petroleum companies, but in my view, these national managers and directors do not have 'effective control' in the sense that one would have when majority of the shares were owned by Papua New Guineans as was the case with Orogen Minerals Limited, or as is the case in Petromin and Mineral Resources Development Company Limited.

As if loss of control through loss of majority-share ownership is not enough, it is my argument that the PNG government has also lost its ability to control and regulate the mining industry to an entity, the Minerals Resources Authority (MRA), which was established in 2005. According to section 5 of the *Minerals Resources Authority Act*

[5] 'Affected' landowners are customary owners of land within a mining lease or petroleum development and pipeline licence area. Provincial Governments and Local-level Governments in whose geographical jurisdiction in which mining or petroleum production occurs are defined as 'affected': see section 3, *Oil and Gas Act 1998.*

2005 (MRAA), the legislation that established the Authority, the functions of the Authority, are:

(a) to advise the Minister on matters relating to mining and the management, exploitation and development of PNG's mineral resources;
(b) promote the orderly exploitation for the development of the country's mineral resources;
(c) oversee the administration and enforcement of the *Mining Act 1992*, the *Mining (Safety) Act 1977*, the *Mining Development Act 1955*, the Ok Tedi Acts and the Ok Tedi Agreement, the *Mining (Bougainville Copper Agreement) Act 1967*, and the agreements that are scheduled to that Act, and any other legislation relating to mining or to the management, exploitation or development of PNG's mineral resources;
(d) to negotiate mining development contracts under the *Mining Act 1992* as an Agent of the State;
(e) to act as agent for the State, as required, in relation to any international agreement relating to mining or to the management, exploitation or development of PNG's mineral resources;
(f) to receive and collect, on its own account and on behalf of the State, any fee, levy, rent, security, deposit, compensation, royalty, cost, penalty, or other money or other account payable under the Mining Act 1992, the *Mining (Safety) Act 1977*, the *Mining Development Act 1955*, the Ok Tedi Acts and the Ok Tedi Agreement, the *Mining (Bougainville Copper Agreement) Act 1967*, and the agreements that are scheduled to that Act, or any other Act the administration of which is the responsibility of the Authority from time to time;
(g) on behalf of the State, to receive and collect from persons to whom a tenement has been granted under the Mining Act 1992 the security for compliance with the person's obligations under the Mining Act 1992 required to be lodged with the Registrar, and to hold such security received or collected;
(h) on behalf of the State, to administer and be responsible for the administration of any public investment program relating to mining;
(i) to conduct systematic geo-scientific investigations into the distribution and characteristics of PNG's mineral and geological resources located on, within or beneath the country's land mass, soils, subsoil and the sea-bed;

(j) to provide small-scale mining and hydro geological survey data services, and occupational safety community awareness programs;

(k) to collect, analyse, store, archive, disseminate and publish (in appropriate maps and publications) on behalf of the State geo-scientific information about PNG's mineral and geological resources;

(l) to carry out such functions as are given to the Authority by this Act or by any other law; and

(m) generally to do such supplementary, incidental, or consequential acts and things as are necessary or convenient for the Authority to carry out its functions.

These functions are to be performed by an *ex officio* Managing Director appointed by the Public Services Commission from a shortlist of three selected candidates submitted by the Minister for Mining pursuant to the *Regulatory Statutory Authorities (Appointment to Certain Offices) Act 2004*. The Managing Director's functions are to manage the Authority in accordance with the policies and directions of the Board of the Authority.[6] The Board of the Authority comprises:

(a) the managing director;

(b) Head of the Department of Finance or his delegate;

(c) Head of the Department of Treasury or his delegate;

(d) Head of the Department of National Planning or his delegate;

(e) Two persons nominated by the President of the PNG Chamber of Mines and Petroleum;

[6] Section 24, *Minerals Resources Authority Act 2005*.

(f) Two persons nominated by the President of the Business Council of PNG, who must be members of one or more of the PNG Law Society, the PNG Institute of Accountants and the PNG Institute of Directors; and

(g) Head of the Mining Department or his delegate (MRAA, s 9 (1)).

While the 'Authority is not a Department of the National Public Service',[7] the functions enumerated above essentially comprise public service functions that are performed by the Mining Department under the *Mining Act 1992*. Key functions of the Mining Department under the *Mining Act 1992* include the screening of applications for mining exploration and development licences, general regulatory functions, and the right to collect State revenue from royalty, rent, compensation, application fees, transfer instruments and sale of geological information, as well as enforcing the mining environmental regulations. All these functions have been effectively taken over by the Authority. The Mining Department is now an empty shell that is kept in place with public funds when it serves no useful purpose.

The above legal framework demonstrates that not only PNG's mineral resources, but also the PNG government's regulatory functions are effectively influenced and controlled by foreign interests. For instance, of the nine-member Board of the MRA, four come from the business industry, which the mining legislation is supposed to regulate. The PNG Chamber of Mines and Petroleum is the public relations arm of the foreign mining and petroleum companies operating in PNG. Likewise, the PNG Business Council represents the interests of the private sector, including the very mining companies the MRAA

[7] Section 7, *Minerals Resources Authority Act 2005*.

regulates. How could the private mining industry screen its own applications for mining tenements, sets its fees, determine the rents and compensation it is obligated to pay, enforce the environmental regulation against itself, and generally police its own operations? What is the guarantee that the private sector, with well-resourced information as well as funds, cannot influence the other Board members who come from the public sector who are often under-resourced to make decisions in their favour rather than the people of PNG? Conflict of self-interest is obvious, and yet, the PNG government had been heavily influenced by foreign advisors and donor agencies to adopt such a draconian legislation.[8]

Based on the forgoing review, it is beyond argument that PNG has the *private foreign ownership* regime type. The deeming ownership provisions in the mining and petroleum legislation above have ensured the extinguishment of customary ownership rights. Having extinguished customary ownership rights, the State's ownership rights are then transferred to foreign corporations in return for licence fees, royalty fixed at 2 percent, tax revenue, and the elective right to take up equity, all of which are insignificant compared to the amount that would be earned from majority share ownership. The ultimate consequence is capital flight from majority foreign share ownership and control leading to the resource curse or underdevelopment.

Why did the PNG nation-state extinguish customary ownership rights if it cannot own majority shares in mining and petroleum projects for the collective benefit of Papua New Guineans? Why cannot the government allow the traditional landowners to own minerals

[8] The World Bank funded the mining and petroleum industry reforms and was involved in it.

and petroleum beneath their land, and own majority of the shares in the extraction and production business? Why has the government taken away minerals and petroleum ownership rights that originally belonged to the customary landowners and transfer them to foreigners? If the government is willing to extract minerals and petroleum with foreigners, why can it not do the same with customary landowners, or Papua New Guinean companies? The second leg of the legal argument advanced by the resource curse thesis deals with these questions. Leif Wenar who advanced the second segment of the legal explanations argues that property rights of indigenous people in resource-rich developing countries have not been enforced or recognized because of the anti-market practice of 'might makes right' rule of colonialism and imperialism.[9] The next section below reviews PNG's colonial legal history to determine how this 'might makes right' rule was applied.

II. COLONIAL ROOTS OF STATE OWNERSHIP IN PNG

Before the 'might makes right' rule was introduced through colonialism, indigenous tribes who inhabited the *state-free* island of PNG asserted ownership and property rights in minerals and petroleum by virtue of first discovery, possession and use of the island long before the Europeans arrived.[10] For instance, the *Handa*, my kin-based tribe in the Southern Highlands Province (SHP) of PNG, used oil from natural seeps as medicine to treat scabies, sores, and head lice, and for body decorations, and gas for burning and shaping arrows without producing smoke, which could attract enemy attention during

[9] Leif Wenar is professor at the School of Law at Kings College, London. The explanation is provided in his article, 'Property Rights and the Resource Curse' (2008) 36 (1) *Philosophy and Public Affairs* 2-32.

[10] Lockean property theory supports the indigenous landowners' claim based on first discovery and use.

tribal warfare.[11] Without consent, authority or regard to traditional ownership and property rights, and without any form of compensation, the British and later Australian colonial governments asserted dominium over all precious minerals and petroleum and introduced legislation for their exploration and production.

The first set of laws for that purpose were adopted in 1888 by the *Courts and Laws Adopting Ordinance 1888* from the following sources:

- Statutes and regulations, which were in force in the colony of Queensland as at 17 September 1888, which were specifically adopted.[12]
- Laws and statutes of Great Britain which were in force in Queensland, which were specifically adopted;[13] and
- Principles and rules of common law and equity, which were in force in England as at 17 September 1888.[14]

Rhetorically, these laws were to apply subject to the circumstances of PNG. In reality, however, they did not. By virtue of the adopted common law, all gold and silver in British New Guinea, and after 1905, Australian Papua, became Crown minerals following the *Case of Mines*.[15] *The Goldfield Ordinance* of 1888, adopted from Queensland, merely gave legislative force to this common law position. The circumstance in PNG

[11] I have used oil and gas in this manner during my childhood in my village. Three famous natural seep occurrences in my region are called *Hip Tek* (my village), and *El Tek* (where gas is produced) and *Are Tek* (neighbouring village), which became popular in the 1980s when production was at its peak.

[12] Section 2, *Courts and Laws Adopting Ordinance 1888*.

[13] *Courts and Laws Adopting Ordinance 1888*, section 3.

[14] *Courts and Laws Adopting Ordinance 1888*, section 4.

[15] *Case of Mines* (1568) 1 Plowd 310 at 336; 75 E.R. 472.

then, as it is today, was that the indigenous landowners owned these minerals, but the 'subject to the circumstances' test was not applied. Instead the 'might makes right' rule was enforced.

This basic legal framework remained after the Commonwealth Government of Australia took over the administration of the British Possession of New Guinea in 1905. The passage of the *Papua Act 1905* by the Commonwealth Government in fact affirmed that '*the laws in force in the Possession of British New Guinea shall continue in force'* until other provisions were made.[16] The *Papua Act* also specified that, apart from legislation adopted from Queensland, Acts of the Parliament of the Commonwealth of Australia were not to apply in Papua.[17] Thus, most of these colonial legislation were based on equivalent legislation in Queensland, which have been retained after independence as part of the laws of PNG.

The *Mining Ordinance 1911* (Papua) for the first time divested customary landowners of their rights in petroleum by deeming all petroleum to have always been the property of the Crown.[18] The *Mining Ordinance* of 1907 vested all mineral rights including those covered by *The Goldfield Ordinance* of 1888 in the Crown. Section 1 of the 1907 ordinance provided: '*All mineral gems and precious stones on or under native lands shall after the passing of this Ordinance by the property of His Majesty*.'[19] Before the 1907

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[16] *Papua Act 1905*, section 6 (1).

[17] *Papua Act 1905*, section 7.

[18] The Legislative Council amended section 55 of the *Mining Act 1898* of Queensland (adopted) to insert a deeming provision (section 2), which stated that coal shale and petroleum have always been the property of the Crown.

[19] The *Mining Ordinance* 1907 (Papua) was replaced by the *Mining Ordinance* 1937. Section 1 of the 1907 ordinance re-appeared as section 167 under the 1937 ordinance. R. S. O'Reagan, QC, in 'The

and 1911 Ordinances, the general mineral and petroleum legislation was the adopted *Mining Act* 1898 of Queensland. That Act was adopted by the *Mining Ordinance 1899* (Papua). The 1907 and the 1911 ordinances were promulgated to specifically vest property in minerals and petroleum in the Crown because the adopted 1898 Act of Queensland did not do so. The general purpose of the 1898 Act adopted by the 1899 ordinance was to regulate the rights of miners who pegged their claims to mineral fields they have discovered in the colony.

In New Guinea, the *Mining Ordinance 1922* was the first legislation to vest property rights in all minerals and petroleum in the Administrator.[20] That ordinance was later replaced by the *New Guinea Mining Ordinance* 1928. In Papua, the 1907 mining ordinance was replaced by the *Mining Ordinance* 1937. The *Mineral Oil and Coal Ordinance* 1923 was the first comprehensive petroleum law to regulate petroleum exploration and development in Papua. This ordinance remained the basic law until repealed and replaced by the *Petroleum (Prospecting and Mining) Ordinance 1938-1939*, an ordinance based on British and New Zealand legislation.[21] Since the administration of Papua and New Guinea were not yet consolidated, a separate copy of the 1938-1939 ordinance was made for New Guinea. After amalgamation of administration of Papua and New Guinea in 1947, single laws were passed for both territories, for example, the *Petroleum (Prospecting and Mining) Ordinance* 1951. The 1951 ordinance remained

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Ownership of Minerals and Petroleum in Papua New Guinea: A Comment' [1992] *Queensland University of Technology Law Journal* p.141, at p.143, says that section 167 of the 1937 ordinance was the first provision of this kind in Papua to vest minerals in the Crown, but in my view the first vesting provision was section 1 of the 1907 ordinance.

[20] The Administrator, *Territory of New Guinea Annual Report – 1921-1922*, at 98.

[21] F. K. Rickwood, 'Geology of Western Papua' [1968] *The APEA Journal* 51, at 52.

until 1975 when it was repealed and then re-enacted as an Act of the National Parliament of the Independent State of PNG, a mere act of formality to comply with constitutional requirements of the new nation-state.[22]

After independence, a more modern petroleum legislation was enacted in 1976. That legislation provided in section 5 (1) that '*all petroleum and helium at or below the surface of any land is, and shall be deemed at all times to have been, the property of the State*.' This has now been replaced by the *Oil and Gas Act 1998* with the same deeming ownership provision under section 6 (1) as seen above. The current *Mining Act 1992* is also an adopted version of the colonial mining ordinance that went through similar repeal and adoption processes as the petroleum legislation with a similar deeming provision in section 5 (1) as cited above.

The above legal history establishes that the PNG nation-state's ownership of minerals and petroleum is deeply rooted in the colonial legal order. Indeed, section 248 of the PNG *Constitution* affirms that the PNG nation-state simply *inherited* mineral and petroleum property rights of the colonial government upon independence. Section 248 provides: 'All property that was, immediately before Independence Day, vested in the body corporate a that time known as 'The Government of Papua New Guinea' is, on that day, vested in Papua New Guinea, and all rights and liabilities…of that body immediately before that day are, on that day, rights and liabilities of Papua New Guinea.' It is useful

[22] The *Laws Repeal Act 1975*, enacted by the pre-independence House of Assembly, repealed all pre-independence legislation and then adopted them as Acts of Parliament of the Independent State of Papua New Guinea.

to note that not only all property rights but also all liabilities were inherited as well. This included foreign loans incurred by the colonial government, as we will see below.

One might argue that mineral and petroleum rights were not inherited but acquired by legislation enacted pursuant to section 2 (2) of the *Constitution*. Section 2 (2) declares that the PNG nation-state has *permanent sovereignty* over natural resources within its territory. The sovereignty is, and shall remain, absolute, subject only to international law obligations that are freely accepted by PNG in accordance with its *Constitution*. The Constitutional Planning Committee (CPC), which prepared the Constitution, explained that this provision was made to emphasise PNG's right to exercise effective control over its natural resources and their exploitation as a free and sovereign nation.[23]

Some Papua New Guinean lawyers have argued that mineral and petroleum property rights were not *inherited* but *acquired* by post-independence legislation promulgated in exercise of the State's sovereignty over natural resources granted by section 2 (2) of the *Constitution*.[24] However, other opinions seem to favour the inheritance view. In *Peter Donigi v. The State*, Brown J, sitting as a judge of the National Court of PNG, implies that mineral and petroleum property rights were *inherited* from the colonial government. Although this view is not expressly articulated, it is inferred from his statement that: 'The

[23] Constitutional Planning Council Report (CPC), chapter 15, at 3, cited in Brian Brunton and Duncan Colquhoun-Kerr, *The Annotated Constitution of Papua New Guinea* (Waigani: UPNG Press, 1984) 29.

[24] For example, Peter Donigi (lawyer) argues that section 2 (2) does not give proprietary rights but declares political sovereignty and the power to legislate, and Posman Kisakiu (also a lawyer) adds that it was in exercise of that sovereign power that the State enacted the mining and petroleum legislation to vest in itself property rights in minerals and petroleum. For Donigi's argument, see Peter Donigi, *Indigenous or Aboriginal Rights to Property: A Papua New Guinea Perspective* (Utrecht, The Netherlands: International Books, 1994) 37. For Kisakiu's argument, see Posman Kisakiu, 'Resources and the future of Customary Land in PNG' [April-June 1993] *PNG Resources Reporting on PNG's Petroleum, Mineral and Forestry Industries* 75.

actions then of all persons, corporations and the State vitally interested in mining whether gold or petroleum have been predicated by this continuing expression of ownership in the State.'[25] When he said *this continuing expression of ownership*, His Honour was presumably referring to the vesting provisions since the 1907 mining ordinance and the 1911 petroleum ordinance in Papua, and the 1922 ordinance in New Guinea, up to the present time. O'Regan, QC, supports this view. He argues that although the post-independence mining and petroleum legislation 'purport to vest mineral and petroleum rights in the State they do not do so. That had been done long before Independence in both Papua and New Guinea. The sections [i.e. section 5 of the 1992 *Mining Act* and the 1976 *Petroleum Act]* merely declare what has been the law for many years.'[26]

The *inheritance* view can be supported by the construction that the vesting sections of the post-independence legislation do not, in fact, vest minerals and petroleum rights in the State, but merely declare what has been the law since the colonial days. In other words, the State used its power under section 2 (2) of the *Constitution* to declare property rights that had already devolved to it under section 248, as opposed to acquiring them in the exercise of that power.

One might counter this view by pointing out that such an interpretation would conflict with the purpose and operation of the *Laws Repeal Act 1975*, enacted by the pre-independence House of Assembly, which repealed all pre-independence legislation. Since the *Laws Repeal Act* repealed all pre-independence mining and petroleum

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25 *Donigi v. PNG* NC 100, at p.8.
26 O'Regan, above n50, at p.144.

legislation, one cannot contemplate that the pre-independence legislation somehow continued to remain in force.

This argument must be considered in the context of the constitutional arrangements respecting pre-independence legislation. The repealed legislation were *adopted* and *re-enacted* as Acts of the National Parliament by operation of section 20 (2) and (3), and Schedule 2.6 of the *Constitution*. So, it is argued that insofar as the mining and petroleum legislation were *adopted*, ownership vested in the colonial government devolved to the PNG nation-state, and in as far as those *repealed* legislation were *re-enacted*, the State acquired ownership in exercise of its powers under section 2 (2) of the *Constitution*. In the absence of nationalism and demand for independence, there was no deliberate and violent severance from the colonial legal order.[27] The legal arrangements were made by Australia for a smooth transition and transfer of power and political independence. There is, therefore, no doubt that the colonial roots of mineral and petroleum ownership simply transferred to the neocolonial PNG nation-state.

III. COLONIAL JUSTIFICATION FOR STATE OWNERSHIP

A. For Common Good and Equitable Distribution

Three justifications are given for the PNG nation-state's ownership of minerals and petroleum. The first reason stems from colonial policy that since the State is a corporate entity of all the isolated collective tribes that make up PNG, it is proper that these resources were vested in the State to enable it to ensure equitable distribution from their

[27] On the absence of nationalism, see Edward P. Wolfers, 'State of the Nation' in W. J. Hudson (ed), *Australia's New Guinea Question* (1975) p.1.

exploitation among Papua New Guineans.[28] This policy justification was first raised in the pre-independence House of Assembly when Bougainville customary landowners challenged the colonial government's right to claim ownership and property rights over the gold and copper ore deposits at Panguna under their customary land. Since the Bougainville Copper Mine was the first large-scale mining project in PNG, the debate that ensued between the Bougainville landowners and their supporters on the one hand, and the colonial government on the other, reveals the Australian roots to this *common good and equitable distribution* policy justification.

The landowners, through their representative, Paul Lapun, a member of the House of Assembly (MHA), demanded royalties and 40 percent of the profit from the Bougainville copper mine to be paid to them. Mr. Henderson, then Assistant Administrator for Economic Affairs in the colonial House of Assembly, argued quite forcefully, that:

> Either the State owns the minerals or the private individual – there can be no compromise… Once the principle of all the people owning the minerals is compromised, there will be trouble… We have done everything possible to protect his (the owner's) rights but the minerals in this country belong to all the people. They do not belong, nor should they belong, to the owner of the land – to a person who has a good fortune of sitting on top of a mineral.[29]

Although this reasoning sounds consistent with and appears to reflect Melanesian egalitarianism and spirit of common welfare, it in fact has deep roots in Australian

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[28] Ciarau O'Faircheallaigh, *Mining and Development: Foreign Finance Mines in Australia, Ireland, Papua New Guinea and Zambia* (1984) p.220.

[29] House of Assembly Debates, Vol.1., No.9, 1503-4, quoted in R. Bedford and A. Mamak, *Compensation for Development: The Bougainville Case* (1977) 15.

mineral policy. The original policy in the Australian colonies, based on the common law, was that ownership of natural resources was linked with ownership of land. '*The British common law, inherited by Australian colonies upon white settlement, included a presumption that the owner of land is entitle to all that lies above and below the surface. Natural resources such as minerals were regarded as part of the land in which they naturally occurred and accordingly passed into private ownership upon Crown grant of the land, unless specifically reserved.*'[30] However, in the last quarter of the 19th century, all Australian colonies changed this policy by reserving all minerals in Crown grants, and over time, extended it to include petroleum. Today all Australian States have legislation vesting ownership of minerals and petroleum in the Crown.[31]

In PNG, the common law position is consistent with customary law: the owner of the surface land owns all that is beneath. The only difference is that under the common law, one holds individual title to land which can be dealt with as a commodity, whereas under customary law in PNG, title is collectively held in trust by current owners for future generations.

Based on custom and the common law, which did not conflict with PNG customary law, most indigenous and some white members in the colonial House of Assembly opposed Henderson's views. Percy Chatterton, a former missionary, was one of those who argued that '*the principle of State ownership is a figment of Mr. Henderson's imagination. No*

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[30] Michael Crommelin, 'Federal-State Cooperation on Natural Resources: The Australian Experience' in J. Owen Saunders (ed), *Managing Natural Resources in a Federal State* (1986) 296-297. Emphasis added.

[31] Ibid.

such principles exist. Under the common law of England we are told minerals belong to the owner of the land under which they are found, except in the case of gold and silver, by ancient custom and of coal by modern legislation.'[32] Percy pointed out that what Henderson sought to introduce into PNG was based on the Australian thinking and practice that since the whole Australian continent is a land belonging to no one (*terra nullius*), it belongs to the Crown, and accordingly, the Crown owns all minerals and petroleum below.[33] In PNG, customary land ownership is fully recognised and protected by legislation so the customary owners were legitimate owners of the minerals and petroleum beneath their land.[34]

Chartterton's opposition was not based on custom, but firstly based on the ground that it was inconsistent with British practice and the common law, which applied in PNG, and secondly, it was culturally discriminatory. The Catholic Church on Bougainville supported these views. In defending the customary landowners' rights, Bishop Leo Lemay, argued that 'Australian ordinances, no matter how appealing these are to us Europeans, will not solve apparently opposite points of view on these vital…issues.'[35] McCarthy, another white MHA, argued the customary landowners' position very persuasively:

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[32] P. Chatterton, *Territory of Papua & New Guinea*, *House of Assembly Debates* (1966) 1926. Emphasis added.

[33] Ibid.

[34] A very useful discussion on this point is provided by Lawrence Kalinoe, 'The Bases of Ownership Claims over Natural Resources by Indigenous Peoples in Papua New Guinea' in Lawrence Kalinoe and James Leach (eds), *Rationales of Ownership* (2001) ch.5.

[35] Bishop Leo Lemay, 'Bougainville People Still Stand Apart', *Pacific Island Monthly*, February 1967, p.143.

> to the people of Papua & New Guinea, land is the most important thing in their lives… According to him (Papuan or New Guinean), when a man owns land in Papua & New Guinea, he owns all the things below the surface of the land. Now the European custom in this is different. We have told the people about the Australian law that permits a man to own land, but the minerals beneath it belong to the government.[36]

Two Bougainvillean elders colourfully expressed what McCarthy argued at a meeting in Bougainville between 60 Rorovana and Arawa villagers and their MHA, Paul Lapun, and government representatives: '*Our ground is like skin to us – we can't sell it. I cannot become a bird. I cannot become a fish.*'[37] In other words, just as the skin of a person's body is an integral part of the whole, so are minerals and petroleum forming an integral part of the whole land. Severing the useful and rich part and leaving behind the rest is unthinkable and illogical.

This is not to say that customary landowners in PNG are unreasonable and cannot extract useful part of land for his or her benefit. Rather, it is to emphasise the importance of the owner's *control*. To use the same two elders' analogy, one cannot allow a stranger to extract his/her *skin* for his/her benefit while he/she is still alive, and as if he/she has no control over his/her body. To the elders, surrendering *control* to foreign transnational corporations to extract the useful and rich minerals amounted to losing *control* over their land and natural resources. This logic about losing *control* and the need to retain *control* was well taken by Ashton, a white MHA, who argued:

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[36] McCarthy, *Territory of Papua & New Guinea, House of Assembly Debates* (1966) 1927.
[37] *Post Courier* (Port Moresby), 29 July 1969, p.1.

> the public in Kieta are fairly happy about CRA generally. They realize that money from mining does bring benefits, but the people who own land are unwilling to lose control, and if we do not offer and inducement, such as shares, or if we reject the amendment without compromise, then we cannot expect any happy solution to this problem.[38]

The Bougainvilleans were willing to mine the copper ore by themselves as owners of the land and minerals with the help of Conzinc Rio Tinto of Australia (CRA) and the Administration, instead of transferring ownership to the latter. The landowners were not anti-government, anti-CRA, anti-Australian, or anti-development as some authors argued.[39] The landowners' position is well reflected in the following passage:

> We thank CRA for discovering our copper, and if they wish to help us mine it, it is right that they should share in the profits. But the copper belongs to us. It is a tradition, a law throughout Bougainville, that the people own the things in the ground, as well as those on top of it.[40]

This view correctly reflects the customary landowners' position in PNG today. *Control* over the production and extraction of natural resources on and beneath their customary land is what the landowners seek. In other words, economic independence and freedom by asserting control over the extraction of natural resources on their customary land is preferred to the current practice where foreign transnational corporations extract these resources while they remain as spectators.

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[38] Cited by Jerome Kevin Lemein Semos, *Natural Resources, Nasioi Society and the Colonial and Post-Colonial State in Papua New Guinea: The Mining and the Undermining of Resource Sovereignty and Resource Development in the Bougainville Copper Project 1963-1990,* (PhD thesis submitted to the Centre for Pacific Studies, Tropical Environment Studies and Geography, James Cook University, 1998)p.227.

[39] A. Mamak and R. Bedford with Leo Hannett and Moses Havini, *Bougainville Nationalism: Aspects of Unity and Discord* (Bougainville Special Publication No. 1, Christchurch, 1974) p.10.

[40] C. Luana, 'Bek Long Bougainville: Gavman i Pulim Mipela Long Wanpela Rot Tasol', *New Guinea*, December 1969/January 1970, p.77.

Debates in the Federal Parliament of Australia also reflected division between those who supported the customary landowners' position, and those who supported the colonial State. For instance, Senator Turnbull, a Federal Labour Opposition Member of Parliament, blasted the Administration's position as *'blatant hypocrisy and the worst features of colonialism, in that Australians were appalled at the government's decision to compel native landowners to virtually give away their land for the benefit of mining interests...for a mere pittance. The whole exercise amounted to ...robbing the natives of Bougainville of their rights.'*[41] Even sympathetic members of the Australian public spoke out against the colonial policy contending that under common law, and in countries like the United States of America, landowners are allowed to own the minerals and petroleum beneath their soil, so why not follow that in PNG.[42]

Despite these oppositions, those who argued for State ownership were not convinced. To them, '*minerals are owned by all the people of the Territory, therefore, the people of the Territory have a right to share in the use of the money which is gained from royalties paid when the minerals are taken out of the ground and sold*.'[43] This view prevailed.

B. For Modernisation

The second justification for State ownership is based on the view that large mining and petroleum projects are *modernisation projects* that promise to promote the economic development and industrialisation of PNG. The Bougainville project was developed at a

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[41] *Post Courier* (Port Moresby: 21 July 1969) 3. Emphasis added.
[42] *Sydney Morning Herald*, 2 March 1967, 2; ------ ------ , 28 May 1969, 4.
[43] D. Grove, Territory of Papua & New Guinea, *House of Assembly Debates*, 8th Meeting of 1st Session, 2 March 1966 (1966) p.1922. Emphasis added.

time when PNG was seeking ‘big impact’ projects to modernise the ‘soon-to-be’ independent country, and also to unify the fragmented tribal peoples under one nation.[44] Bougainville also served as a *face saving project* for Australia, which received international criticism for its failure to develop the colony during its administration and prepare it for self-rule.[45]

Informed by modernisation theory, the United Nations (UN), through its Trusteeship Council, specifically mandated Australia to encourage primary production in agriculture and extraction of natural resources through foreign direct investment (FDI) in order to develop the Territory,[46] and prepare it for self-determination.[47] The World Bank also recommended Australia to introduce appropriate policies that would ‘encourage rapid but sound expansion of the Territory’, with specific attention to ‘the best method by which we might unlock the riches lying dormant in this country.’[48] These recommendations were in line with general *academic consensus* that PNG was economically not viable in the absence of a capitalist exchange economy and hence the need to explore, discover and develop a large mining or petroleum project that would generate sufficient internal revenue.[49]

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[44] D. Oliver, *Aspects of Modernisation in Bougainville, Papua New Guinea* (Working Paper Series, University of Haiwaii, 1981); --------- ,*Black Islanders* (1991) pp.118-159.

[45] The United Nations was specifically critical of the non-development of PNG: *Sydney Morning Herald* (Sydney) ‘Attack on New Guinea Administration by the UN’, 9 August 1969.

[46] Ron Crocombe, ‘That Five Year Plan’, (December 1968/January 1969) 3 (3) *New Guinea*, 57-70.

[47] C. E. Barnes, ‘The Years Ahead’ in *Selected Statements on Papua & New Guinea During 1965*, (1966 & 1967).

[48] The Commonwealth Government of Australia, *Programmes and Policies for the Economic Development of Papua and New Guinea* (Parliamentary Paper No. 156, Canberra, 1968) pp.1-2, 41-44.

[49] See D.G. Bettison, E. K. Fisk, F.J. West, and J. G. Crawford, *The Independence of Papua New Guinea: What are the Pre-requisites?: Four Lectures Presented Under the Auspices of the Public Lectures Committee of the Australian National University* (1962).

With overwhelming support for a large-impact project, when large copper ore deposits were found in Bougainville, the colonial government was 'in so much of a hurry' to have it developed that it did not find the time to consult the customary landowners about it.[50] When Grove and Henderson introduced two separate but identical bills, which revised the *Mining Ordinance 1928-1966* for New Guinea and Papua in the 8 June 1967 sitting of the House of Assembly, they argued that because the bills '*are basically just one piece of legislation we do not wish to debate*'.[51] Many MHA wondered why the bills had to be rushed through. Ian Downs, a white MHA, reveals the reason:

> This bill is one which the Government wishes to hurry through during the present meeting – WHY? I was told it is because the bill can be put to use if a large company wishes to mine in TP&NG. Previously the mining legislation of the Territory followed the mining laws of Australia. It is a good law for the miner, but not for the owner of the land.[52]

These mining laws were passed without consulting the customary landowners because the laws were good for the miners and not the landowners. Since many indigenous MHA were illiterate, they were powerless to present effective debates on behalf of their people. For those who were educated, meaningful debate was gagged. For instance, Sir John Guise, an indigenous MHA, suggested a number of amendments favourable to the customary landowners, but all were rejected except one.[53] Some members in the Australian Federal Opposition described the Administration's attitude as one that '*places*

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[50] Paul Lapun, quoted in Peter Robinson, 'Birth of a Mining Giant', *Australian Financial Review*, 16 July 1969, at p.2.

[51] Territory of Papua & New Guinea, *House of Assembly Debates* (1966) p.1505. Grove was then Director for Lands, Surveys and Mines. Italics supplied.

[52] Ian Downs, Territory of Papua New Guinea, *House of Assembly Debates*, 8th Meeting of the 1st Session, Vol. 1, No.8, (14 June 1966) pp.1464-67.

[53] Territory of Papua & New Guinea, *House of Assembly Debates*, (14 June 1966) p.1505.

profits before people' since not one word is said of any negotiations with landowners, while 'long consultations had taken place between the company, the Administration and the Department of External Affairs' since 1964.[54] The landowners were '*the last people to be consulted'*[55] because the Administration did not want any procrastination in its pursuit of what an observer called '*a copper way to civilization',* referring to the promised civilization the Bougainville copper project would bring to the 'uncivilized' Papua New Guineans.[56] Indeed, this was no secret as C. E. Barnes, the then Administrator, expressed:

> we need companies like Conzinc Riotinto to come here…[and] we must use every endeavour to encourage those who are prepared to invest $100 million in a remote area like this. We must do everything to see that they go ahead with it.[57]

The Administration was so fixated on the *copper way to civilization* that any objection to it, or challenge to its ownership, no matter how cogent and meritorious, were simply dismissed as views of a few 'stirrers' and 'negative media publicity'.[58] To the Administration, the choice was *'whether to drift in a primitive and backward situation…and [being] burdened by their ancient customs or whether to advance as a modern state financed substantially by its own resources*.'[59] To the colonial

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[54] Stewart, Commonwealth of Australia, *House of Representatives Debates* (12 August, 1969) pp.22-23. Emphasis added.

[55] Peter Robinson, 'Birth of a Mining Giant', *Australian Financial Review* (Sydney) 16 July 1969, p.2. Emphasis added.

[56] Anonymous, a Letter to the Editor, *Sydney Morning Herald* (Sydney) 14 august 1969, p.2. Emphasis added.

[57] C. E. Barnes, *Programmes & Policies for the Economic Development of Papua & New Guinea* (1968) p.115.

[58] Editorial, *Sydney Morning Herald* (Sydney) 30 July 1969, p.2.

[59] C. E. Barnes, Commonwealth of Australia, *House of Representative Debates* (12 August 1969) p.18. Emphasis added.

administration, the Bougainville copper mine represented modernisation, advancement and strength, while opposition to it by landowners insisting on respect for and recognition of their customary rights represented backwardness, weakness and being primitive.[60] To the Administration, the Bougainville copper mine was indeed a 'short cut' to '*economic development and…the key to a broad range of industrial development*.'[61] Since the project was '*a major and essential development in the economic future of the Territory of Papua and New Guinea*,' it was imperative that the State gave CRA unequivocal support.[62]

Many critics argued that focus on large-scale natural resources projects would not modernise PNG but turn the country into '*a colony of Australian business interests*.'[63] This view was reinforced by the manner in which the *Mining (Bougainville Copper Agreement) Bill* (BCA) was rushed through the House of Assembly in its June 1967 sitting. Notwithstanding the landowners' dispute on State ownership, and their opposition to the mining, and refusal to lease customary land for mining purposes, or if these positions were to be compromised, then their demand for royalty and substantial shares in the project, the colonial government surprisingly did not include the Bougainville landowners in the negotiation of the BCA and made them parties to that agreement. To the customary landowners, the true parties to the BCA should have been the customary landowners on the one hand, and the colonial State and CRA on the other. This was not the case. The Bougainville landowners therefore saw the BCA as a

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[60] Semos, above n37, at p.216.

[61] C. E. Barnes, (1967) 59 (12) *Australian Mining*, p.17. Emphasis added.

[62] C. E. Barnes, Commonwealth of Australia, *House of Representatives Debates* (12 August 1969) p.15. Emphasis added.

[63] Ron Crocombe, 'That Five Year Plan', (December 1968/January 1969) 3 (3) *New Guinea* p.57.

unilateral agreement because both the colonial State and CRA were Australian entities.[64] Since the exclusion of the indigenous landowners effectively removed any meaningful participation, the very people who would be affected by the project, and in whose name and for whose benefit the modernisation objective was pursued, there was no doubt in the people's mind that the modernisation rhetoric was to turn the Australian political colony into an *Australian business colony* once PNG became independent.

C. For Internal Revenue Generation

The third justification for State ownership was based on the need to *generate internal revenue* for the PNG nation-state to become financially viable and self-sufficient.[65] In its Country Report on Papua New Guinea published in 1978, the World Bank noted that about 90 percent of the cultivated land in PNG occupied subsistence agriculture, which supported 60 to 70 percent of PNG's then population of 2.8 million people.[66] '*Insulated by mountains, forests, large rivers, and sea, the original Stone Age tribes have until recently lived unto themselves in conditions of primitive isolation. …Members of the group have an obligation to assist and support others who might be in need – a tribal society security system that makes members reluctant to leave the protection of the tribal environment*.'[67] Because of this social security system and collective values, the people enjoyed (and continue to enjoy) a:

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[64] Semos, above n37, at pp.210-211.

[65] See Bettison, Fisk, West, and Crawford, above n40.

[66] The World Bank, *Papua New Guinea: Its Economic Situation and Prospects for Development: A World Bank Country Economic Report* (1978).

[67] Id., at pp.14-15. Emphasis added.

> fairly reasonable standard of living in the rural subsistence sector [and this provided] little incentive for local people to enter the modern cash economy with great speed. In addition, there was virtually no tradition of manufacturing, and hence, there were almost no small-scale industries. Traditional trade was also limited. With the expatriate-dominated modern sector of the economy expanding fairly rapidly, Australian policy inevitably widened the gap between the modern sector and Papua New Guinea's traditional society.[68]

While the indigenous people were self-sufficient, the colonial creature - the PNG nation-state – was not. The nation-state needed money to fund its rule over the country. The 1978 World Bank Country Report in its *Preface* noted that:

- PNG State continued to rely on Australia's annual budgetary grant, without which PNG's central government budget and its balance of payments would not be viable.
- Foreigners (mainly Australians) played dominant role in a number of modern activities in the public and private sectors requiring skills or high-level manpower.[69]
- In order to assist PNG to become *financially self-reliant*, the Bank would extend development loans to PNG upon being satisfied of PNG's own creditworthiness – a judgment based on whether the country would become self-supporting, '*a term that implies an ability to service foreign debt on commercial or semi-commercial terms*.'[70]

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[68] Id., at 21.
[69] This status quo remains. In 1994, AusAID estimated that expatriates occupy 85 percent of the top jobs in the private sector.
[70] The World Bank, above n65., at pp.xii-xiii.

Indeed, the World Bank and its soft-loan affiliate, the International Development Association (IDA), had already extended loans to PNG before PNG's independence. In 1975, the newly independent government had inherited K211.4 million in external debts owed to the following institutions:

Table 10.3

CREDITOR	**LOAN AMOUNT (a Kina then equivalent to US$1)**
• IDA	K14.5 million
• World Bank	K29 million
• Australia	K103.7 million
• Australian 'Government Loan'	K36.1 million
• Private Institutions	K67.6 million
• International Agencies	K44.8 million
• Asian Development Bank	K1.3 million
• Germany	K16.2 million
• Switzerland	K15.0 million
• Japan	K12.8 million
• Eurobond Market	K18.9 million
Total External Debt	**K211.4 million**

Source: Constructed from 1978 World Bank Country Report, p.206.

Since the indigenous Papua New Guineans lived fairly reasonable standard of living in their subsistence economy, without being lured by the cash economy, in whose interest, and for whose benefit, were these loans acquired? It is submitted that it was in the State's interest. Since the State had financial obligations, it was in its interest to rush the mining legislation and mining agreement in the House of Assembly to mine the copper ore deposits at Panguna.

Likewise, since Melanesian subsistence farmers had no tradition in manufacturing and business, what was the PNG state's *creditworthiness* on which basis the World Bank and other international institutions made loans to the PNG government? It is submitted that it

was the State's ownership of potential mineral and petroleum resources. The World Bank indeed admitted that PNG had favourable resource endowment such as the Bougainville copper mine and the prospect of mining the Ok Tedi copper ore which could offset the loans.[71]

In this manner, the people of PNG were long before independence trapped in a 'debt-trap' through the PNG nation-state, which claimed (and claims) to represent the best interest of the people. The PNG nation-state had mortgaged (and continues to mortgage) the country's actual and prospective natural resource revenues to secure foreign loans to finance the capitalist economy primarily controlled by foreign corporations and a few local elites who control the PNG nation-state and its institutions.

The internal revenue justification, while worthy on face value, is nothing more than an excuse to collect resource revenues to service foreign loans borrowed for the support and maintenance of the nation-state itself. Part of the resources revenues are used to maintain the nation-state so that it could remain viable for the benefit of the capitalist economy. The subsistence economy, and the indigenous people who depend on it, are deprived of their land and natural resources by the nation-state to finance its continued existence.

IV. CONCLUSION

The RCT now seriously challenges these justifications for State ownership. Development observers confirm that PNG has not benefited from its extractive industries. The country has been cursed by its resource abundance. The legal remedy to resolve this curse is to

[71] The World Bank, above n65., at pp.14-15; 54-55.

revamp the current ownership regime inherited from the colonial rulers by either restoring ownership back in the indigenous landowners who must own 51 percent or more of the shares in any natural resources projects, or allowing private domestic companies with majority share ownership held by citizens to extract these resources with the support of foreign transnational corporations.

Turnbull's argument that the Administration's insistence on vesting mineral ownership in the State amounted to *robbing the natives* than the Administration's *fair and common good argument* is true. By the time the Bougainville copper mine commenced production in 1972, the 1967 BCA signed between the Administration and BCL, a CRA subsidiary, had terms that favoured the company. The State had 20 percent equity, which it purchased with $26 million loan secured from the Australian government, and received only 1.25 percent royalty on the value of the concentrate export. The landowners received only 5 percent of the 1.25 percent, which is about 6 cents out of every $100 in sales. Meanwhile, BCL was given a 42-year mining lease, a three year tax holiday period, accelerated depreciation period, and other tax incentives.[72] According to one former colonial Administration official, this arrangement was '*a good agreement, a fair agreement, a far-sighted agreement and one of the best ever negotiated between Government and private enterprise for a mining development project*.'[73]

[72] John Momis, 'Taming the Dragon', in Peter Sack (ed), *Problem of Choice: Land in PNG's Future* (1974) p.196, cited in Semos, above n37, at pp.234-235.

[73] D. Mentz, 'Administrative Aspects of the Bougainville Agreement' (Paper presented at a seminar at La Trobe University on 10 October 1969 on the topic, *P&NG Society of Victoria: Background to Bougainville – A Factual Analysis*) p.12. Emphasis added.

Although that 'fairness' was repudiated by a renegotiated agreement in 1973 by a nationalist government, similar terms with minor improvements are found in subsequent mining and petroleum agreements today.[74] Unfair terms like this will remain and continue to deny Papua New Guineans their legitimate and fair share until customary ownership is restored, or domestic corporations with majority shares held by PNG citizens begin to extract these resources.[75] Papua New Guineans must own and control the extractive industries with the support of the government to lift the country out of poverty, underdevelopment and the resource curse.

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74 Royalty has increased slightly from 1.25% to 2%, and the State reserves the right to acquire 30% 'carried' equity in large mining projects and 22.5% in petroleum projects. These royalty and equity benefits are then shared with customary landowners 'affected' by the projects. While these may be good improvement on the original Bougainville agreement, they are not good enough to escape the resource curse syndrome.

75 Based on the United States' experience, Gavin Wright and Jesse Czelusta, in 'The Myth of the Resource Curse' (Stanford University: December 2003), available online at http://www.stanford.edu/~czelusta/Challenge.pdf, <accessed 15 May 2007), support domestic private ownership of natural resources.

CHAPTER ELEVEN

CURSE IMPLICATIONS OF PAPUA NEW GUINEA'S NATURAL RESOURCES BENEFITS-SHARING REGIME

INTRODUCTION

This chapter examines the law and policy on management of mineral and petroleum revenues flowing to the Papua New Guinea (PNG) Government and how they are distributed among various stakeholders under what is called the 'benefits-sharing regime' (BSR). Section I examines the BSR. Section II discusses the implications of the BSR by arguing that:

- the BSR obfuscates the ownership and control issue;
- contradicts the rationale for State ownership of minerals and petroleum;
- contradicts the national development goals outlined in the PNG *Constitution*; and
- primarily provides insurance against social and political risks posed by victims of the resource curse or underdevelopment.

The section also looks at the implications of the benefits-sharing agreement (BSA) relating to PNG's first liquefied natural gas (LNG) project concluded on 20 May 2009. Section III makes two alternative policy suggestions for PNG to replace the BSR. The last section provides a conclusion. The purpose of the chapter is to show that local political elites and foreign capitalists combine to maintain the BSR that causes accumulation by dispossession of Papua New Guineans by preventing them from

controlling and owning majority shares in mining and petroleum projects in the country, and promoting a culture of dependency on 'free handouts'.

I. THE BENEFITS-SHARING REGIME

Three major financial benefits flowing to the PNG government from mining and petroleum projects comprise fiscal income, equity and royalty. Fiscal income comprises corporate income tax previously levied at 50 percent but since 2002 reduced to 30 percent in order to encourage foreign investment, and tariffs and import duties.[1] Equity is based on the government's reserved right to take up to 22.5 percent in petroleum and 30 percent in large mining projects. Royalty is calculated at 2 percent of the well-head value of oil and gas in petroleum projects and the export value of mineral exports. Two percent of the 22.5 percent equity in oil and gas projects and 5 percent of the 30 percent in mining projects are assigned to 'affected' provincial and local governments and landowners under the respective mining and petroleum legislation.[2] Non-financial benefits from mining and petroleum projects include the promise to provide employment opportunities, create economic linkages, undertake infrastructure projects, and transfer technology and skills.

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[1] Sir Moi Avei, 'Government Initiative in the Petroleum Sector' (Paper presented at the PNG Mining and Petroleum Investment Conference, Sydney, 03 December 2002). Sir Moi, then Minister for Petroleum and Energy, announced the reduction of the tax rate from 50 percent to 30 percent.

[2] 'Affected' provincial governments and local level governments means the geographical jurisdiction of these governments in which the oil and gas or mineral project is located. 'Affected' landowners means the customary landowners within a special mining lease or petroleum development licence: see section 3 *Oil and Gas Act 1998*.

A. Development Forum

Both financial and non-financial benefits from mining and petroleum projects shared between the national government on the one hand, and the 'affected' provincial governments, local-level governments and landowners on the other, are discussed and agreed during what is called a 'development forum' process. Since the *Oil and Gas Act 1998*, unlike the *Mining Act 1992*, provides detailed prescriptions on the development forum process, it is useful to look at that legislation as an example of the forum process in both industries. Section 48 of the *Oil and Gas Act 1998* mandates the Minister for Petroleum and Energy of the PNG national government to convene a development forum, 'being a meeting to which are invited persons who, in the view of the Minister, fairly represent all persons or organisations which the Minister believes will be affected' by a petroleum project, including:

- the petroleum company intending to develop the oil or gas reservoir;
- incorporated land groups or other entities representing landowners who would be 'affected' by the proposed oil or gas project as determined by the Minister pursuant to section 169 of the *Oil and Gas Act 1998*;[3]
- Local-level governments who would be 'affected' by the proposed oil or gas project;
- Provincial governments who would be 'affected' by the proposed oil or gas project; and

[3] Section 169 entails the procedure for ministerial determination of 'affected' landowner beneficiaries based on social mapping studies undertaken by petroleum exploration companies during the exploration phase.

- any other persons or organisations, which the Minister considers would be affected by the petroleum project including customary landowners of pipeline licence areas.

Before convening a development forum, section 49 expressly states that *'a development forum shall not be convened in respect of a proposed petroleum project until'* oil companies intending to develop an oil or a gas field and the national government have complied with the following:

- The company intending to apply for a development licence must submit a full-scale social-mapping and landowner identification study to the Minister for determination of the 'affected' landowner beneficiaries.[4] The social-mapping study is one of the conditions of a petroleum prospecting licence.[5] Based on such a study, the Minister then determines landowner representatives who need to be invited to attend the forum.[6]
- An environmental impact assessment as well as a socio-economic impact study must also be lodged with the Department of Environment and the Department of Petroleum and Energy.[7]
- The Director of the Department of Petroleum and Energy must prepare a proposal, after giving due consideration to the full-scale social mapping and landowner identification study and the socio-economic impact study, for the

[4] Sections 47 and 49, *Oil and Gas Act 1998*.
[5] Section 47, *Oil and Gas Act 1998*.
[6] Section 49 (b), *Oil and Gas Act 1998*.
[7] Section 49 (c), *Oil and Gas Act 1998*.

equitable sharing of royalty and equity benefits with the 'affected' landowners. Such a proposal must be served on the landowner representatives before convening a development forum.[8]

Section 50 provides for the final outcome of the matters agreed between the forum parties to be incorporated into a development agreement.

B. Development Agreement

Generally, development agreements are fairly standard although details may vary from project to project, depending on the matters agreed to among the parties to a development forum. A development agreement essentially entails the benefits and obligations of the parties, some of which are already specified in the respective mining and petroleum legislation. Let us take the Moran petroleum development agreement as an example.

1. Moran Development Agreement

The *Development Agreement Relating to the Central Moran Petroleum Development Project between the Independent State of Papua New Guinea and the Moran Project Area Landowners, Hulia Local-level Government and the Southern Highlands Provincial Government* (MDA) was held at Kavieng in the New Ireland Province and executed on 11 February 2001. In exercising his powers granted by section 48 of the *Oil and Gas Act 1998*, Chris Haiveta, then Minister for Petroleum and Energy, invited Pape Punga, an illiterate landowner from Moran as chairman and a few of his supporters as the landowner representatives instead of Tony Kila, an educated elite (Community School

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8 Section 49 (d), *Oil and Gas Act 1998*.

Teacher) appointed by the landowners and his team comprising other educated elites.[9] Kila and most of the Moran landowners questioned how an illiterate representative would read and understand the MDA written in English and negotiate effectively on their behalf. Kila and his team hence protested immediately that the development forum was a farce. They argued that the forum was not convened in the true spirit of the legislation with their legitimate representatives. The government ignored the protest and proceeded to conduct the development forum and executed the MDA with Punga's team. Consequently, the Moran landowners were divided between those who supported Kila and those in favour of Punga. Although some form of compromise was reached when Kila was offered a directorship together with Punga on the Petroleum Resources Moran Limited (PRM) board, occasional conflicts flare among the landowners.

The MDA has six parts: Part A – General; Part B – National Government Undertakings; Part C – Southern Highlands Provincial Government Undertakings; Part D – Hulia Local Level government Undertakings; Part E – Landowner Undertakings; and Part F – Formal Clauses. Under Clause 3.1 of Part B, the national government agreed to grant 2 percent of its 22.5 percent equity provided for under section 165 of the *Oil and Gas Act 1998* to the Moran landowners and the Hulia Local Level Government (HLLG). Clause 3.2 provides that the Moran landowners, the HLLG and the Southern Highlands Provincial Government (SHPG) can purchase additional equity from its remaining 20.5 percent if Orogen Minerals Limited (now demised) decides not to exercise its option to acquire the State's equity. Clause 3.3 divides the 2 percent equity between the Moran landowners to receive 95 percent and the HLLG to take the remaining 5 percent. Subsequent

[9] I was included on Kila's team as Secretary of the landowner association headed by him.

negotiations have led to the inclusion of Margarima, Komo, Mount Bosavi, Kutubu and Nipa Local Level Governments to share the 5 percent. The landowners' portion is then divided between the Huli Morans receiving 70 percent and the Fasu Morans taking the remaining 30 percent. Both landowner factions are then bound by legislation and the MDA to reserve 30 percent of their respective equity for future generations, 30 percent to be held in trust to be expended on health, education and agricultural projects in their area, and the remaining 40 percent to be distributed in cash to individuals through registered incorporated land groups.[10]

Petroleum Resources Moran Limited (PRM) mentioned above is a trustee company wholly owned by Mineral Resources Development Company Limited (MRDC), which holds and manages the 2 percent equity for the benefit of the 'affected' beneficiaries.[11] On the PRM board are Tony Kila and Pape Punga of Moran representing the Huli landowners, Paul Yawe, a representative of the Fasu Moran, and representatives of the SHPG and the State. Sunk costs of the 2 percent were borne by the State, and the State's costs were borne by the company, which costs were reimbursed from the State's share of revenue.

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10 Section 176, *Oil and Gas Act 1998*, and Clause 3.6 of the MDA.

11 Section 176 (4) and (5) of the *Oil and Gas Act 1998* provides for the landowners' as well as provincial and local level governments' portion of the equity to be held by such a trustee company wholly owned by MRDC. Similar trustee companies such as Petroleum Resources Kutubu Limited, Petroleum Resources Gobe Limited, Mineral Resources Porgera Limited and Mineral Resources Star Mountain Limited are owned and managed by MRDC on behalf of affected landowners and provincial and local level government beneficiaries from these mining and petroleum project areas.

The State's 2 percent royalty entitlement[12] is wholly granted to the same 'affected' landowners and provincial and local level governments who receive the equity benefit.[13] Clause 4 of the MDA provides details of the royalty sharing arrangement between the Moran landowners and the SHPG as well as the various local level governments in the region.

Three main non-cash benefits the national government undertook to provide under the MDA include infrastructure, local business development, and training and localization. Let us take a closer look at each of these non-cash benefits.

(a) Infrastructure

A list of infrastructure projects identified by the 'affected' landowners and provincial and local level governments are appended to the MDA. Since Moran is located in the inhospitable and rugged mountains of the Papuan highlands, which is often described as 'broken bottle' country, and not connected by roads to any government administrative towns, and without schools, health services and other government services, roads, schools and health infrastructure dominate the infrastructure list in the agreement. According to the MDA, funding for infrastructure would come in the form of tax credit schemes and development levies.[14] In essence a tax credit scheme is a tax-deductible scheme where mining and oil companies are authorised by the government to provide infrastructure in a

[12] Section 159, *Oil and Gas Act 1998*.
[13] Section 168, *Oil and Gas Act 1988*.
[14] Amended by *Oil and Gas (Budget Provisions 2000) Act No.21 1999*, and *Oil and Gas (Amendment) Act No.53 2000*, respectively.

mining or petroleum development project area.[15] Section 160 of the *Oil and Gas Act 1998* stipulates that an oil company shall pay development levy to 'affected' provincial and local level governments in accordance with section 98 of the *Organic Law on Provincial and Local Level Governments* calculated at 2 percent of the wellhead value of all petroleum produced from that province.[16] Clause 5 of the MDA provides details on how such development levy shall be distributed between the SHPG and the various local level government beneficiaries. Clauses 5.2 and 6.2 provide for development levies to be used for the development and maintenance of infrastructure projects in the Moran area.[17]

Section 178 of the Act establishes the procedure for disbursement of the all infrastructure grants made to 'affected' landowners and 'affected' provincial and local level governments. Clause 6 in the MDA merely regurgitates the details under section 178, so it is useful to set out how infrastructure grants are to be managed under that section. Section 178 (1) expressly states that '*all grants made in accordance with Section 173, and all monies held on behalf of an affected Local-level Government or affected Provincial Government in accordance with Section 176 and available to be spent by the affected Local-level Government or affected Provincial Government, shall be administered in accordance with this section*.' Subsection (2) then goes on to provide that the Minister *shall* establish, in respect of each petroleum project, an Expenditure Implementation Committee (EIC) comprising the following persons:

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[15] Under section 159, if an oil company paid development levy specified under section 160 of the *Oil and Gas Act 1998* and royalty in the same financial year, then the royalty payment will be regarded as income tax paid by it for that year under the *Income Tax Act 1959*.

[16] *Oil and Gas Amendment Act No.21 of 2001* effected this change.

[17] According to section 173 (3) of the *Oil and Gas Act* 1998, project grants such as development levies can be made in the form of monetary payments or in the form of provision of infrastructure or services or other benefits.

(a) Secretary of the Department of National Planning who shall be Chairman of the EIC;

(b) the Director, appointed by the Minister for Petroleum and Energy pursuant to section 11 of the *Oil and Gas Act 1998*;

(c) Secretary of the Department of Treasury;

(d) Secretary of the Department of Works and Transport;

(e) Secretary of the Department of Provincial and Local-level Government Affairs;

(f) the Administrator of each affected Provincial Government or District Administrator responsible for an affected Local-level Government; and

(g) the chief executive of the oil company operator who shall represent the licensees of the petroleum project, or their representative.

Subsection (3) expressly states that no project grants *shall* be made except only in accordance with development plans submitted by the relevant Local-level Government or Provincial Government, and in accordance with the approval of the EIC. According to subsection (4), the EIC *shall* be responsible for:

(a) monitoring budgets and timetables for construction and implementation of grant and benefit expenditure on behalf of affected local and provincial governments;

(b) monitoring tax credit expenditures under section 219C of the *Income Tax Act 1959* to ensure that the projects so funded comply with the development plans submitted by the relevant local or provincial government; and

(c) monitoring the program of ongoing infrastructure expenditures.

Clause 6.2 of the MDA provides that the Minister for Petroleum and Energy shall establish the EIC in consultation with the Member of the National Parliament for Komo-Margarima, the Chairman of the Homa Paua People's Association Inc. representing the Huli Moran landowners, the Chairman of the Aporo'Uri Resource Owners Association Inc. representing the Fasu Moran landowners, and the President of the Hulia Local-level Government.

Despite these unequivocal provisions and the national government's undertaking reinforcing these provisions in the MDA, the EIC for the Moran petroleum project has not been formed for a number of years since the signing of the MDA on 11 February 2001. Yet the Departments of Petroleum and Energy, Treasury and Finance, and National Planning have dished out infrastructure grants and development levies to mysterious persons for the years 2001-2004. In 2004, Oil Search Limited released a cheque worth K6 million (AU$3 million) development levy to the Southern Highlands Provincial Government with the consent and approval of these responsible government departments. Mr. Hami Yawari, then Governor of the Southern Highlands Province, received the cheque and applied it on unbudgeted projects that promoted his political

interests.[18] In the same year, Mr. Pape Punga, the illiterate Chairman of the Huli Moran landowners, caught a man named Pombre Inji at the corridors of the Treasury Department receiving a cheque worth K200,000 for a bogus building his company allegedly constructed for a fictitious health centre in the Moran Huli area. Mr. Inji promptly wrote a cheque for K120,000 to Mr. Punga and begged him to cover up the fraud.[19] Mr. Inji also informed Mr. Punga that the rest of the money would be shared among senior government officials within the Departments of Petroleum and Energy and National Planning and Treasury who assisted him.

The Homa Paua People's Association wrote several letters to the responsible government departments about the fraud and the lack of accountability and the need to immediately establish the EIC pursuant to the *Oil and Gas Act 1998* and the MDA. The Association also pointed out that although infrastructure development grants have been made, there is nothing to show for it. No response was received on these correspondences. Some executive members of the Association then met with senior officers of Oil Search Limited and sought their assistance to withhold further development levy payment until the EIC was formed. Oil Search advised that their legal obligation was to make the payments and how it was managed was the government's responsibility. However, they assisted by raising the matter with the Minister for Petroleum and Energy, Sir Moi Avei, and fixed an appointment for executive members of the Association to meet with him to discuss the issue. The Association executives met the Minister on 21 May 2004. The Minister directed responsible officers in his department to comply with the legislative

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[18] This is based on my personal inside knowledge of how the money was used.

[19] Mr. Punga did not cash the cheque. He gave me the original copy, which is still with me today (May 2009). Punga then made formal complaints with the police but nothing has been done on it.

mandate to form the EIC, which would properly vet and account for Moran infrastructure projects. No action was taken on this matter in 2004. Between 2005 and 2007, it was alleged that a particular politician from the Southern Highlands Province fraudulently misappropriated over K10 million infrastructure grants.[20] As at 2008, many important infrastructure projects such as the Moran-Tari Road and the Sebiba-Baguale Road under the MDA are yet to be provided. Funds set aside for these projects have not gone through the legally established channels simply because successive governments have failed to establish the EIC before any funds are disbursed.

(b) Local Business Development

Clause 7 of the MDA provides that the national government will endeavour to ensure that business contracts and sub-contracts arising from the Moran petroleum development project are awarded to competent landowner companies. Clause 7.3 spells out the preferential order in which business contracts will be awarded. First preference will go to companies owned and operated by 'affected' landowners. Second preference will be given to businesses owned and operated by people from the Southern Highlands Province. The third preference will be given to joint business ventures between 'affected' landowners and others from the Southern Highlands.

Generally, the national government hardly promotes local businesses. In fact, it is the oil companies operating the Moran fields that have ensured that business contracts are preferentially awarded to 'affected' landowners. The national government does not seem

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[20] This is subject to a criminal prosecution in 2008-2009, acted upon by the police as a result of complaint laid by the State Minister, Philemon Embel, in the 2007-2012 Somare government.

to have any useful policies or programs to promote local businesses to participate meaningfully in oil and gas development projects apart from what they call ‘seed capital’ initially provided in the formation of what is generally called ‘umbrella’ companies. Even then this form of capital is a one-off payment not in any way designed to ensure success and sustainability of landowner companies with follow-up support programs.

(c) Training and Localization

Under Clause 8 of the MDA, the national government undertakes to ensure that preferential training, employment and localization of jobs are undertaken in favour of the ‘affected’ landowners, followed by those from the Southern Highlands, and then other Papua New Guineans. The undertaking includes the promise to secure a half-yearly report from the Moran petroleum project area in relation to the implementation of the training and localization programs. Clause 8.3 specifically states that the national government will assist the SHPG to secure scholarships for landowner students to undertake studies within PNG or overseas on oil related subjects or other general fields of study. Clauses 8.4 and 8.5 reiterate that training programs and sponsorship for studies include both within PNG as well as in any foreign country, and the ‘affected’ landowner associations will be consulted in this regard.

Although some scholarships for landowner students have been provided to study in institutions within PNG, Oil Search Limited who administers the sponsorship packages in consultation with the landowner associations had persistently claimed that it is not their policy to sponsor students to study in overseas institutions. The national government, in

fact, does not have any proper program to ensure appropriate training in any field that may be useful for the long-term interest of national development. In practice, sponsorship is based on parents from the area who face financial hardships lodging standard application forms prepared by Oil Search Limited which are then screened with selected landowner leaders to determine who is a landowner student applicant and who is not. Applications from many students from neighbouring villages such as Margarima, Nipa and Tari deemed 'not affected' and 'non-landowners' are often rejected. The real power to determine who gets sponsored or not rest with executives of the landowner associations and Oil Search Limited. The national government's undertaking remains a rhetoric.

(d) Provincial and Local Level Government Undertakings

The undertakings of the SHPG and the HLLG are to ensure that funds earmarked for infrastructure would be expended on the nominated infrastructures in consultation with the 'affected' landowners from Moran and in accordance with their annual budgetary appropriations. The SHPG and the HLLG also undertake to ensure that conflicts are resolved peacefully and the Moran petroleum project is protected from interruption by disgruntled landowners. The SHPG further undertook to make an annual review of implementation of the infrastructure projects identified and appended to the MDA, and undertook to own and maintain the infrastructures.

Due to national government weakness and oversight such as the failure to establish the EIC, and rampant corruption and political infighting in the SHPG, these undertakings

have never been implemented. The HLLG has no office, administrative centre, and no educated personnel to implement its undertakings. Monies set aside for the infrastructure projects such as the K6 million in 2004 have been flagrantly misused to gain political power and personal prestige by politicians and bureaucrats from the province.[21] Meanwhile, oil has continued to flow while most of the promised infrastructures are yet to be provided to the 'affected' landowners, thereby sowing the seeds of discontent among the landowners.

(e) Landowner Undertakings

Under Clause 13 of the MDA, three key undertakings of the 'affected' landowners are that, firstly, their associations and incorporated landgroups who receive ex-gratia payments and development grants would file written audited reports twice a year with the Department of Petroleum and Energy on all such monies they had received from the national government. In order to strengthen the functions of landowner associations in filing this biannual reports as well as acting as political 'mouthpiece' of the 'affected' landowners, the Moran Hulis would contribute 20 percent and the Moran Fasus 7 percent of their royalty and equity entitlements to their respective associations. Second, the 'affected' landowners undertook not to disrupt the oil flow from their land. In the event of any dispute or conflict, the landowners would seek to have it resolved through consultation and in accordance with law. In the event of breach of this undertaking, the landowners would pay for any costs incurred and loss associated with the project. The

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[21] Details of the rampant corruption and misuse of oil money is too much to detail here. It is fit for another thesis or book. I have personal knowledge and documentary records on the matters discussed here.

landowners would not stop or delay or hinder the construction and production of oil from their Moran fields.

After the conclusion of the agreement the Moran Huli landowners have breached their undertaking by stopping construction and production when the national government failed to honour some of its commitment. On one occasion in 2003, construction was stopped when employment opportunities were offered to other 'non-affected' landowners when Oil Search Limited overlooked qualified landowners who could do the job. On another occasion construction was stopped due to allocating business contracts in favour of the Moran Fasus who have already benefited from the Kutubu project compared to the Moran Hulis who needed to participate in the service contracts generated by the oil project. Generally, the national government has failed to honour its commitment and tend to respond only when angry landowners descend upon the production facilities and threaten to stop production and damage oil company camp and assets.

2. Other Development Agreements

The oil and gas development agreements for the Hides, Kutubu and Gobe projects have similar provisions to that of Moran, and like Moran, development funds have been mismanaged too. Even mining development agreements between the national government and 'affected' landowners and 'affected' provincial and local level governments in Lihir, Porgera and Ok Tedi, which are generally considered as well-

managed, have failed to deliver tangible projects to the communities in those regions because of mismanagement.[22]

In the case of Kutubu, for instance, all Kutubu infrastructure funds were initially paid to Kutubu Development Authority (KDA), an entity created by the SHPG. Two major landowner groups from Kutubu, the Fasus and Foes, were beneficiaries of those infrastructure funds. The landowner representatives on the KDA board, headed by Hami Yawari of the Foe tribe as Chairman, and Mark Sakai of the Fasu tribe as Deputy Chairman, have utterly failed to serve their people well by building infrastructure with the oil funds made available to the KDA. In fact, the Kutubu infrastructure funds are quite substantial compared to similar funds flowing to other mining and petroleum projects in the country. Yet, government and landowner elites have misappropriated the funds in the name of bogus projects that were never delivered to the people of Kutubu.[23] After a leadership tussle both within the SHPG and among the Kutubu Foe landowners, and after several court battles and out-of-court battles on the missing infrastructure funds, the Somare Government in 2002 replaced the KDA with the Kutubu Special Purpose Authority (KSPA), which is now responsible for the management of the project funds.

Cash components of Kutubu benefits from royalty and equity have also been subject to misuse. While the Fasu faction has stable leadership under Mr. John Kapi Nato who

[22] I had personal discussions with landowner leaders from these areas with inside knowledge who provided this assessment, but compared to oil and gas project areas, the mining projects have done better in terms of delivering community services.

[23] Several litigations on this issue in the National Court at Waigani, PNG, between 2001-2003 never got heard because the court was desirous of seeing the parties settle out of court, instead of it hearing the allegations. Accordingly, KDA funds remains missing and unaccounted for to this day (10 May 2009).

ensures proper distribution among various clan stakeholders, the Foe faction under the leadership of Hami Yawari has been marked by controversy and mismanagement. One of the flagrant abuses has been the de-registration of already registered land groups and the registration of additional bogus land groups from the original 56 incorporated since commencement of oil production in 1992 to 109 land groups by 2001.[24] While 20 new land groups were probably genuine, the rest were obviously bogus. The Registrar of the Department of Lands, without proper inquiry, facilitated the de-registration and registration of additional land groups. Mr. Yawari, Secretary of the Foe Landowners Association Inc., the political 'mouthpiece' of the Foe landowners, purposely registered the new land groups in order to claim equity and royalty paid to them, and use proxy votes from these bogus land groups to cement his position in the Foe Association.

In 2002, Mr. Yawari used his oil wealth to mount a successful campaign to get him elected as Governor of the Southern Highlands Province. During his regime from 2002-2007, infrastructure funds from Gobe, Moran, Kutubu and Hides have been used at his discretion in flagrant disregard for the laws and development agreements. The K6 million Moran project funds in 2004 mentioned above were misappropriated during his term as Governor. His Foe Landowners Association lost respect and recognition from the Somare Government in 2002. A rival association, namely Foe PDL2 Landowners Association Inc. under the leadership of Mr. Norman Ba'abi, is now the recognised political 'mouthpiece' of the Foe landowners.

[24] Twenty-six (26) legitimate land groups registered based on Chevron Niugini Limited's social mapping studies between 1992-1994 were de-registered in April 1999, and there were further de-registrations after that, and additional registrations between 1999 and 2000. I was engaged by the Foe PDL2 Landowners Association to review the legality of these actions, but the National Court never conclusively ruled on it, favouring the parties to settle it out of court, which never eventuated.

Various documentary evidence comprehensively proves that Mr. Yawari has abused millions of Kutubu MOA funds, which have been brought to the attention of the police and responsible political and bureaucratic officials, but no action has been taken against him.[25] In one instance in 1999, Mr. Yawari fraudulently withdrew K900,000 from monies set aside in the Foe Future Generation Fund. Senior police officers terminated a junior officer within the Police Department who investigated the matter and had just completed his file and was just about to charge and arrest Mr. Yawari.[26] In 2001, Michael Ogio, then Acting Prime Minister, wrongly authorised the withdrawal of over K3 million royalty and equity entitlements already lawfully disbursed to Foe landowners under the Kutubu petroleum development agreement. The original cheque was cancelled and a new cheque of the same amount was reissued to Mr. Yawari who cashed it immediately and appropriated it personally.[27] Angry Foe landowners retaliated by closing the main oil valve station of the Kutubu oil pipeline at Mubi enroute to the loading Kumul Terminal in the Gulf Province, which lasted for almost a week.[28] The issue was resolved when MRDC, under a new management under the leadership of Dan Kakaraya decided to write another cheque in place of the one Mr. Yawari personally appropriated. Although formal complaints were lodged with the police and responsible political and bureaucratic officials, no action was taken against Mr. Yawari for the misappropriation.

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25 I have many of these pieces of documentary evidence.

26 I have a complete report of the fraud squad police investigation file.

27 I summoned the Papua New Guinea Banking Corporation before it was privatized and had them produce the detailed records of how he used the money.

28 This action was taken as a last resort when police failed to act, the courts refused to entertain the aggrieved landowners' lawsuit sending them out of court to settle, and when respective government departments ignored to observe proper legal requirements and procedures in the use of the infrastructure funds.

The forgoing examples demonstrate that the 2 percent equity, royalty and project grants provided to 'affected' landowners and 'affected' provincial and local-level governments are subject to misappropriation and abuse. Secondly, it shows that the national government and the 'affected' provincial and local level governments do not have the capacity or capability to honour and enforce the law and their undertakings in project agreements. Because of this failure, landowners tend to take the law into their own hands and use force and threats to get government compliance and enforcement. The review also shows that individuals have hijacked the benefits and used the oil wealth to acquire power and personal privileges, while paying police and government officials from enforcing the law against them. This thesis contends that the BSR, by dividing Papua New Guineans between 'haves' or 'beneficiaries' and 'have-nots' or 'non-beneficiaries' engender such corrupt outcome.

However, one must remember that the misuse of funds relates to the 2 percent equity, 2 percent royalty and 2 percent development levy. The amount is very small compared to the 77.5 percent equity in oil and gas projects and 70 percent in mineral projects that foreigners own. Although funds are abused by political and local elites, these funds circulate and remain in the country compared to the massive 77.5 percent and 70 percent that leave the country. So, comparatively speaking, capital flight of the vast majority of PNG's natural resources wealth negatively affects the country's economy more significantly than local corruption involving the meager 2 percent or the 22.5 percent and the 30 percent PNG receives. Regrettably, the resource curse theorists focus on the

mis/management of the tiny 22.5 percent and the 30 percent, not the 77.5 percent and the 70 percent that leave the country.

Many observers, especially foreigners, have critiqued on how much the 'affected' landowners and provincial and local level governments receive, but have nothing to show for it.[29] In some respects, such blame has merit, for instance, in relation to infrastructure funds. But in relation to the quarterly or biannual or annual royalty and equity payments, what eventually trickles down to the individual is not sufficient to improve their lives, although it is sufficient to make them dependent on the cash handouts, as the following table illustrates.

Table 11.1

Total Royalty and Equity Benefit = K5 million				
Recipients				***Amount in Kina***
Huli and Fasu Moran Landowners		85%	=	4, 250, 000.
Southern Highlands Provincial Government		10%	=	500, 000.
Local-level Governments		5%	=	250, 000.
Moran Huli		70% of 4, 250,000	=	2, 975, 000.
Moran Fasu		30% of 4, 250,000	=	1, 275, 000.
Moran Huli			***=***	***2, 975, 000***
(1)	Future Generations	30%	=	892, 500.
(2)	Social Services	30%	=	892, 500.
(3)	Homa Paua Association	20%	=	595, 000.
(4)	Individual Landowners	20% =		595, 000.
Moran Fasu			***=***	***1, 275, 000***.
(1)	Future Generations	30%	=	382, 500.
(2)	Social Services	30%	=	382, 500.
(3)	Aporo'Uri Ass.	7%	=	89, 250.
(4)	Individual Landowners	33%	=	420, 750.

[29] See, for examples, Glenn Banks, 'Landowner Equity in Papua New Guinea's Mineral Sector: Review and Policy Issues' (2003) 27 *Natural Resources Forum* pp.223-234; Colin Filer (ed), *Dilemmas of Development: The Social and Economic Impact of the Porgera Gold Mine 1989-1994* (1999); R West, 'Development Forum and Benefit Package: A Papua New Guinea Initiative' (Working Paper No.16, Institute of National Affairs, Port Moresby, 1992).

The table above illustrates how a combined K5 million equity and royalty benefits in a year would be distributed under the MDA. The table shows that, after dividing the K5 million among the various equity and royalty beneficiaries, the take-home portion for individual landowners is insignificant. For example, from the K5 million, the amount available for cash distribution among the individual landowners from Moran Huli is K595,000. Assuming there are 1,500 Moran Huli landowners, each individual would get about K396. The table also shows the amount the Fasu Morans would receive from the K5 million. From past experiences, the average amount of equity and royalty entitlements to individual landowners from Moran has been between K100 to K200 due to the small size of the oil production. The total amount varies from time to time based on the fluctuating prices of oil and total volume of production. Generally, whatever the landowners receive is expended on consumable imported goods and hardly any is saved for a rainy day or for investments.[30]

II. IMPLICATIONS OF THE BENEFITS-SHARING REGIME

Three major implications of the BSR are that, firstly, it obfuscates the ownership and control issue; second, it contradicts and nullifies the rationale for State ownership of minerals and petroleum; and third, it provides insurance against social and political risks posed by victims of underdevelopment. This section considers each of these implications as well as the constitutional implications of the BSR. The section also looks at the implications of the controversial development forum relating to PNG's first liquefied natural gas (LNG) project concluded on 20 May 2009.

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[30] I have been involved in distributing cash among individual recipients of royalty and equity benefits in Kutubu and Moran between 2001-2004.

A. Implications on Ownership and Control

Why does the PNG Government allocate its entire royalty entitlement and portion of its equity in addition to lucrative non-cash benefits generated by the country's rich mineral and petroleum projects to a select few so-called 'affected' landowners and provincial and local-level governments to the exclusion of all other Papua New Guineans? This thesis contends that, since the BSR was first introduced in negotiating the Porgera Gold Project in 1989 at the height of the Bougainville crisis, it was intended to obfuscate the mineral ownership and control issue raised by the Bougainville landowners, which was overwhelmingly supported by other Papua New Guineans. There is no doubt that the Bougainville crisis shook the foundation of the State's radical title. The crisis caused the State to rethink its mineral policy. Industrial players also had to rethink their involvement because their investments were at risk. Without recognising customary ownership claims, but in order to protect the mineral industry on which it depends, the State had to sacrifice its royalty and equity interests to appease angry customary landowners by allocating all of its royalty benefits and part of its equity entitlement to landowners on whose land mining or petroleum production occurred. Mining and oil companies, too, beginning with Placer Niugini (a subsidiary of Placer Dome of Canada) that operated the Porgera Gold Mine which persuaded the State that it should provide infrastructure within the special mining lease (SML) area and the Enga Province from a portion of its income tax payable to the State, had to accommodate angry landowners and appease them with infrastructure projects and preferential treatment in terms of employment opportunities, business contracts, and training and sponsorship.

The benefits-sharing model, where the government and industry work together to calm angry landowners by providing cash and infrastructure benefits without conceding title to them, evades the ownership issue. However, to most of the landowners who could not read the fine print of the law assume that the State provides project benefits in recognition of their ownership rights. Since the government does not provide project benefits to other Papua New Guineans except to those within a development licence area, who are customary owners of land identified through social-mapping studies, there are no other explanations for the government's benefits-sharing policy. Neighbouring landowners too believe that project benefits are provided to customary owners of the minerals and petroleum beneath their customary land. If they understood the fact that the benefits were provided because the landowners were 'affected' by a project, then they too would feel entitled to seek some form of compensation because projects indeed affect them indiscriminately irrespective of where they live.

This thesis views that once the true basis of the BSR becomes apparent among the general population, serious problems may arise sufficient to disrupt investments in the extractive industries and the national economy. To avert such an outcome, the State would do well to critically revise the current BSR to ascertain the justifications for concentrating mineral and petroleum wealth in the hands of a select few who do not deserve it because they are not owners of these resources although they may be owners of the land under which minerals or petroleum are extracted. The only justification is that they are 'affected'.

The term 'affected' is large enough to encompass many landowners on the fringes of mining and petroleum projects who do not receive any project benefits. 'Affected Local-level Government' and 'affected Provincial Government' are defined to mean the local and provincial governments in whose geographical jurisdiction a mining or petroleum project is located.[31] Likewise, 'affected landowner' impliedly refers to customary owners of land living within a special mining lease or petroleum development licence area. This means their identity as 'affected' by a mining or petroleum development project and thus entitled to receive project benefits, is determined by geological grids drawn in Port Moresby within the Department of Mining and the Petroleum and Energy Department for purposes of allocating prospecting and development licences to foreign corporations. Even if peripheral villages near big mining and petroleum projects such as the Agu of Yalenda and the Huli of Baguale who live on the fringes of Kutubu and Moran petroleum projects, who are more 'affected' than the Waro and Kantobo villagers who live behind the Iagifu Ridges of the Kutubu oilfields, they are not entitled to receive any benefits.

For this reason, this thesis argues that the BSR engenders and maintains an inequitable and discriminatory national development policy. The BSR engenders social discrimination among rural communities between those who receive money and special preferences in terms of employment, business contracts, training and sponsorship packages and so on, and those who do not. If 'affected' and not 'ownership' of minerals and petroleum is the criteria for distributing benefits to some 'affected' landowners while other 'affected' landowners receive nothing, then such discriminatory policy must be

[31] Section 3, *Oil and Gas Act 1998*.

replaced. It is discriminatory because their status as beneficiaries is determined by geological boundaries drawn up for different reasons but appropriated to fictitiously divide all 'affected' people into 'affected landowners' and 'not affected' landowners.

B. Implications on Justification for State Ownership

In Chapter Ten, we have noted that the State's ownership of minerals and petroleum rests on three justifications: for common good and equitable distribution, modernisation, and internal revenue generation towards economic independence. This thesis contends that the BSR undermines these three justifications. The BSR is not only inequitable but also unjust and discriminatory as argued above. If the government's argument is that minerals and petroleum belong to all the people of Papua New Guinea and as such title in these resources is vested in their collective entity, then every Papua New Guinean has a legitimate expectation to receive some form of benefit from the mining and petroleum projects in the country. However, the BSR prevents that from happening. As the Moran development agreement shows, all mining and petroleum benefits are shared with 'affected' landowners and provincial and local level governments in whose geographical jurisdiction the mining or petroleum project is located. Even employment, training, sponsorship and business opportunities are staked against other Papua New Guineans in favour of the 'affected' beneficiaries. Moreover, revenues collected through tax are given away to the same beneficiaries in the form of tax credit scheme projects. Accordingly, the State's common good and equitable distribution justification can no longer be maintained.

The second justification for State ownership is to cause modernisation or development through capital formation and economic linkages generated by mining and petroleum projects. This thesis argues that that justification is also negated by the BSR. First, as we saw in previous chapters, the extractive industry does not produce sufficient linkages to cause major positive development impacts in resource-rich developing countries. Compounded with that fact is the preferential treatment that only ‘affected’ landowners are allowed to participate in business contracts created by mining and petroleum projects. If other enterprising Papua New Guineans are prevented from doing business in their own country, businesses generated by the extraction of their collectively owned mineral and petroleum resources vested in the State, then foreign corporations extracting these resources and their ‘affected’ hosts cannot develop the country for everyone. Past experiences as in the case of Kutubu and Moran demonstrate that the State’s responsibility to provide infrastructure as part of its modernisation effort are left to ‘affected’ landowners and provincial and local level governments who have squandered millions without having anything to show for it. The State has utterly failed to ensure that modernization projects are undertaken and funds made available for such projects are accounted for. Instead, funds set aside for modernisation projects have enriched a very few who use their wealth to gain power and once achieved, use it for their own personal glory. After the revenue the State collects is wasted on recurrent expenses and debt servicing, nothing is left to undertake investments in agriculture or manufacturing, or in human capital to train Papua New Guineans who could one day be able to extract mineral and petroleum resources without having to rely on foreign expertise. The BSR does not

in any way promote modernisation at all. Accordingly, this justification for vesting ownership of minerals and petroleum in the State is no longer valid.

The third justification, to generate internal revenue to attain economic independence, is also not promoted by the BSR. Instead, the BSR destroys any hope of achieving that objective by allowing resource revenues to be wasted. So much resource wealth has been wasted on consumption such that the trend has now established a *dependency culture* on imported and consumable goods instead of encouraging self-sufficiency and sustainable production in agriculture and manufacturing in order to attain economic independence. For instance, 'affected' landowners who receive royalty and equity benefits tend to spend their money on 'lamp flabs', mobile phones, electronic products such as radios, computer, watches, or on alcohol, plane tickets, hire cars, hotels, and other non-productive items. Since the State's portion of resource revenue is mainly used on recurrent expenditure and servicing of foreign loans, nothing is left for investments to generate income that will be needed at the end of the resource boom.

C Implications on Project Security

The third implication of the BSR – project security – stands out to be the main reason for the government's change of heart to share project benefits with 'affected' beneficiaries in order to avert another Bougainville-type crisis. This thesis indeed takes the view that the BSR serves to protect 'the goose that lays the golden eggs' more than any other reason. In fact there is no secret in this truth as the Moran development agreement demonstrates. In that agreement the landowners undertook not to disrupt the project and ensure that

project funds are properly accounted for in order to prevent other disgruntled landowners from disrupting the project. As Glenn Banks point out in relation to equity participation, for instance, 'equity holding offers, at least on paper, advantages both to communities (an involvement in decision-making, access to information, and share of profits), and corporations (reduced exposure to social risk as communities have less disincentive to disrupt a mine operation in which they are shareholders).'[32] This means that on the altar of project security, the State sacrifices royalty, equity and tax revenue benefits that could be centrally collected and equitably distributed among all Papua New Guineans. By so doing, its justification for continued ownership of minerals and petroleum has been compromised. If not, then the Bougainville crisis exposed the hypocrisy of the three justifications for State ownership, which originated in the colonial administration. Now that these justifications are no longer valid in light of the BSR, the only justification is project security.

D. Constitutional Implications

The BSR conflicts with the National Goals and Directive Principles (NGDP) in the PNG *Constitution*. The first three goals of the NGDP call for PNG citizens and governmental bodies to:

(1) control bulk of the economic enterprise and production;

(2) take effective measures to control and participate in the exploration and production of natural resources; and

[32] Banks, above n24, at p.223.

(3) allow economic development to take place by the use of skills and resources available in the country, either from citizens or the State, and not by imported skills or resources.

In other words, these goals call for exploration and production of natural resources using local skills, knowledge, technology and capital. The Constitutional Planning Committee (CPC) recommended the adoption of these goals after an exhaustive consultation among Papua New Guineans and based on lessons learned in other developing countries.[33] The critical issue was whether PNG had to wait until such time Papua New Guineans acquired the requisite knowledge, skills, capital and technology, or to allow foreign investors to exploit these resources. The CPC left this question open to be addressed in an *Investment Code*. Influenced by the United Nations' (UN) Report on the *Impact of Multinational Corporations on Development and International Relations* published on 9 June 1974 (1974 UN Report), the CPC recommended that, if PNG allows MNCs to exploit its natural resources, they must be strictly controlled and guided by an *Investment Code* incorporated as a Schedule into the proposed PNG *Constitution*. The CPC was aware of arguments against entrenching investment policies as legal provisions in a constitution but they countered: '*We find these arguments unconvincing and consider that they seriously underestimate the political importance of spelling out for all to see the basis on which foreign investment is acceptable in our country*.'[34] But they conceded

[33] See both express and implicit provisions in PNG's *National Goals and Directive Principles* (NGDPs) No.3 – 'National Sovereignty and Self-Reliance' - in the PNG *Constitution* which calls for Papua New Guineans to control the bulk of the economic production and commercial enterprises.
[34] *Constitutional Planning Committee Report* (hereinafter CPC Report), paragraph 132. Emphasis added.

that these investment guidelines, if incorporated as proposed, should be made unjusticiable.[35] The CPC was concerned about the fact that:

> Far too many countries of the Third World are forced, by economic relationships with the industrialized countries, to build their societies more in accordance with the interests of the industrialized countries than with their own national wishes. We firmly believe that Papua New Guinea must avoid a situation where foreign capital controls the destiny of its people.[36]

The CPC correctly believed that to build a successful nation depends ultimately on its people and their leaders. *'No amount of careful planning in governmental institutions or scientific disciplines will achieve liberation and fulfillment of the citizens of our country unless the leaders – those who hold official positions of power, authority or influence – have bold vision, work hard and are resolutely dedicated to the service of their people.'*[37] The CPC came to this belief based on the 1974 UN Report that resource-endowed developing countries have not benefited from their exploitation by MNCs no matter how much benefits the host developing country retained. The CPC's view on this point deserves to be quoted at length:

> Spurs by multinational corporations to productive activities do not always provide a basis for sustained and sound development. Isolated foreign enclaves have few linkages with the domestic economy. The extraction of natural resources may generate few processing industries or do little to raise the level of local skills. Branch plants which operate purely as off-shoots of their parent companies, such as component manufacturers, are unlikely to integrate fully into the local economy. Restrictions to competition may benefit the

[35] Paragraph 133, ch.2, CPC Report.
[36] Paragraph 66, ch.2, CPC Report. Emphasis added.
[37] Paragraph 1 of chapter 3 – The Leadership Code - CPC Report.

> enterprise but not the individual countries in which its affiliates operate. Export market allocation and tight purchases affected the foreign exchange gained or saved by the host country. The attempts of host countries to raise taxes or to place limitations on foreign exchange remittances can be negated by vertically or horizontally integrated multinational corporations through transfer pricing and the use of tax havens.'[38]

The CPC continued:

> [E]ven if a host country increases its share of benefits from the activities of multinational corporations and enjoys high rates of growth, its income distribution may not improve or may even deteriorate. Welfare standards for workers may be kept low, owing to weak or non-existent trade unions. Consumers may not benefit from low prices. High income obtained locally from the activities of multinational corporations may accrue largely to domestic elites associated with foreign interests. The vigorous sales efforts of the affiliate on behalf of products usually consumed in high-income countries may cater largely to upper income groups and promote consumption habits beyond the means of a poor country and unsuitable for the development of local industries. Basic needs of the population, such as food, health, education and housing, may be left unattended.[39]

These views were expressed from the standpoint of nationalist leaders who were preparing for independence in 1975 under the leadership of Michael Somare (now Sir) when he was Chief Minister in the colonial government. Somare introduced 'Eight Aims' to set the country on the path to independence from foreign political and economic domination. The 'Eight Aims' were then expanded and adopted by the CPC as the NGDPs entailed in the *Constitution*. Three of the Aims, the first, second and fifth call for:

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[38] UN Report on the *Impact of Multinational Corporations on Development and International Relations*, at p18, cited in paragraph 83 of ch.2 of the CPC Report.

[39] Ibid.

- a rapid increase in the proportion of the economy under the control of Papua New Guinean individuals and groups, and in the proportion of personal and property income that goes to Papua New Guinea;
- more and equal distribution of economic benefits, including movement toward equalization of income among people and toward equalization of services among different areas of the country; and
- a more self-reliant economy, less dependent for its needs on imported goods and services and better able to meet the needs of its people through local production.

Relevant parts of the NGDPs were adopted in the national government's *White Paper on Petroleum Legislation and Policy* in 1976, which should guide oil and gas development in the country. The White Paper provided for:

(1) citizens and governmental bodies to have control of the bulk of the economic enterprise and production;

(2) strict control of foreign investment capital and wise assessment of ideas and values so that this will be subordinate to the goal of national sovereignty and self-reliance, and in particular for the entry of foreign capital to be geared to the internal social and economic policies and to the integrity of the Nation and the People;

(3) the State to take effective measures to control and actively participate in the national economy and in particular to control major enterprises engaged in the exploitation of natural resources;

(4) economic development to take place by the use of skills and resources available in the country either from citizens or the State and not in dependence on imported skills and resources;

(5) constant recognition of our sovereignty, which must not be undermined by dependence on foreign assistance of any sort, and in particular for no investment, military or foreign-aid agreement or undertaking to be entered into that imperils our self-reliance and self-respect, or our commitment to the National Goals and Directive Principles, or that may lead to substantial dependence upon or influence by any country, investor, lender or donor; and

(6) wise use to be made of our natural resources and the environment in and on the land and seabed, in the sea, under the land, and in the air, in the interests of our development and in trust for future generations.

Current mining and petroleum policies and practices have utterly failed to implement these policies. Instead, foreign aid donors and international financial institutions (IFIs) have become very influential in designing the mining and petroleum development policies of the country, which has led to compromise national sovereignty and economic independence, and allow foreign domination of the extractive industries.

Let us take the role and influence of the World Bank for example. The World Bank has been heavily involved in PNG's economy through various loan programs and recently in the extractive industries through its Technical Assistance Loans to PNG to strengthen the

capacity of the Department of Mining, the Department of Petroleum and Energy and the Internal Revenue Commission.[40] Its aim is to fast-track exploration and development of mineral and petroleum resources in order to alleviate poverty. Serious reform introduced by the *Mineral Resources Authority Act 2005* as seen in Chapter Ten where the mineral industry becomes the regulator as well as the developer is one example of the Bank's influence. Another example relates to the Bank's privatisation crusade since 1991, which ultimately led to the privatisation of Papua New Guinea Banking Corporation (PNGBC), MRDC and Orogen Minerals, among others. A third example relates to its underwriting of environmental risks of the large Lihir Gold Mine which dumps mine wastes containing harmful substances such as cyanide directly into the sea. Since the Minerals Resources Authority (whose board comprises members from the mining industry) has the jurisdiction to enforce environmental laws and regulations, there is a conflict of interest in effective enforcement of the environmental laws against Lihir Gold. This thesis conjectures that the Bank promoted the Mineral Resources Authority (MRA) so that its involvement in the industry such as in Lihir would be shielded from scrutiny and environmental damage claims. The Bank's involvement and influence has led PNG away from pursuing its development goals expressed in the NGDPs of the *Constitution.*

The Bank, as well as commentators supporting the interests of private foreign capital, have been criticising government involvement as equity partner in mining and petroleum

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[40] World Bank, *Papua New Guinea: Competitiveness, Growth and Structural Adjustment* (1992); -------, *Papua New Guinea: Jobs, Growth and International Competitiveness* (1993); ----------, *Papua New Guinea: Improving governance and Performance* (1999).

projects for a long time.[41] In the view of Papua New Guineans, government equity participation is proper and in line with the national development goals. To the private sector dominated by foreigners and donor agencies such as the World Bank, however, government participation is bad for the country for the following reasons:

- It diverts public funds from areas of high social return such as education, health, transport and communication infrastructure that cannot attract private funding.
- It requires the commitment of scarce, qualified government personnel away from infrastructure development projects to protect the government's investments in mining or petroleum projects. Leaving the few qualified government engineers and managers in the public sector is better than taking them away to keep them in the extractive industries.
- The extra manpower required to manage the State's equity is an added cost, which must be factored against returns from the equity holdings.
- The government puts itself in a position of conflict as both a promoter and regulator of the extractive industry, thereby forcing it to compromise either its interests as shareholder or public interests as a regulator.
- Equity holding exposes the government to commercial risks, like other private entities involved in the industry.

[41] See for examples, G. Hancock, 'State Equity Participation in Mining and Petroleum Projects in Papua New Guinea' in R. Rogerson (ed), *Proceedings of the PNG Geology, Exploration and Mining Conference 1994, Lae* (1994) p.280; John Tilton, John Millet and Richard Ward, *Mineral and Mining Policy in Papua New Guinea* (1986).

- Government financial obligation continues even after complete purchase of its equity to finance administrative as well as additional equity costs as experienced in the case of Ok Tedi.[42]
- To maximize revenue, taxation is more certain than dividends from equity participation. As Ok Tedi and Lihir demonstrate, dividends depend on profitability, which marginal projects may not accrue.[43]
- Since Additional Profits Tax (APT) is able to capture exceptional profits from highly profitable ventures, equity is not necessary.
- Finally, equity participation is a disincentive to foreign investment.

As Chapter Ten shows, these policies, advocated on behalf of private foreign investors, combined with the Washington Consensus policies introduced and imposed by the World Bank, the IMF and other aid agencies have effectively pushed the State out of current mining and petroleum projects except Ok Tedi.[44] It is contended that Ok Tedi is avoided because foreign corporations do not want to associate themselves with the globally-exposed embarrassing environmental problems.

Although government participation was once seen as promoting national interest, that is no longer the case. Landowner benefits under the BSR are now promoting project security. In some cases, however, foreign interests who heavily influence mineral and petroleum policies would be happy to see some form of government participation as in Ok Tedi to protect foreign corporations against investment risks.

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42 This relates to the State's cost of additional equity from 20 percent to 30 percent.
43 Hancock, above n36, at pp.282-283; Tilton, Millet and Ward, above n36, at pp.42-43.
44 Timothy Curtin, *Privatization Policy in Papua New Guinea* (NCDS, ANU, Canberra: May 2002).

E. Implications on Gas Development

If the recently concluded development forum in relation to PNG's first liquefied natural gas (LNG) project is any indication, then the State's ownership in minerals and petroleum does not serve any useful purpose at all in terms of promoting the constitutional development goals in the NGDPs. In the case of equity participation in PNG's first LNG project led by a consortium of joint venturers headed by ExxonMobil through its subsidiary Esso Highlands, the State elected to take up only 19.4 percent instead of its full 22.5 percent.[45] Mr. Philemon Embel, State Minister in the Somare Government who participated in negotiating the deal with ExxonMobil, revealed at a Sydney meeting in November 2008 that ExxonMobil insisted that the State should acquire only 19.4 percent. The State had no choice but to accept it, indicating the amount of power and influence transnational mining and oil corporations exert against political leaders of poor but resource-rich developing countries like PNG.

Minister Embel and Governor Anderson Agiru of Southern Highlands also revealed that the PNG government's effort to enact a separate legislation to regulate development and commercialisation of PNG's huge gas reserves was also prevented by the transnational corporations engaged in that industry. The leaders however did not explain why they allowed themselves and the government to be dictated to by these foreign corporations on this important industry whose development will impact the lives of Papua New Guineans for centuries. The leaders stated that the national government accepted the private

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[45] Rumours among some 'affected' landowners say that the State has hidden the difference, the 2.6%, elsewhere for the benefit of some Ministers in the Somare government.

sector's argument that the current *Oil and Gas Act 1998* was sufficient to regulate and govern gas development and the proposed LNG project.

I beg to differ and argue that given the size and impact of the proposed LNG project, which is projected to cost US$11 billion, and given the amount of huge gas reserves in the country, a separate legislation is necessary. In the current legislation, only four sections - 68, 69, 179 and 184 - concern gas development. Section 68 relates to natural gas recovered in a petroleum project, so it is not relevant to a separate natural gas project. Section 69 states that natural gas exports shall be subject to the terms of a written agreement under five brief subsections. Section 184 picks up on section 69 and states that the scope of the terms of natural gas development will be governed by a written agreement between the State and the proposed gas developer.

Of the four sections, only section 179 is the most comprehensive. Subsection (1) provides that the Provincial Governments of PNG shall, acting jointly, be at liberty to incorporate a company to be called the *National Gas Corporation Limited* (NGC) under the *Companies Act 1997*. According to subsection (2) (a), if and when such a company is incorporated, each of the Provincial Governments shall be entitled to a shareholding in NGC in accordance with a shareholders' agreement executed among them. Under subsection (2) (b) and (c), NGC shall act as the corporate trustee for Provincial Governments and landowners to hold and manage their equity in any gas project, including interests in the downstream processing sector. Subsection (2) (d) defines the powers of NGC including the power:

- to do anything necessary to implement the shareholding arrangement described under paragraph (a);
- to obtain petroleum processing facility licences for processing of natural gas and any permits required for NGC to be a domestic gas operator or supplier or owner or operator of facilities for storage or transportation of cylinders containing compressed natural gas or liquefied petroleum gas;
- to hold and enter into agreements with foreign corporate licensees to acquire by agreement on commercial terms participating interests in gas projects;
- to acquire by agreement on commercial terms a participating interest in the Hides Gas Project under petroleum development licence (PDL) 1;
- to acquire by agreement on commercial terms processed petroleum including all liquefied petroleum gas;
- to acquire by agreement on commercial terms an interest in a gas project at such time as any participant in a gas project wishes to sell such an interest; and
- to borrow money for the purpose of acquiring or developing assets held by it under this section, and for that purpose, to charge its assets.

Subsection (2) (e) reiterates that NGC is a corporate trustee similar to MRDC specified under section 176 of the Act. Paragraph (f) grants NGC power to obtain competent and professional managerial services, and to provide quarterly reports and half yearly audited reports to the Minister for Petroleum and Energy. Paragraph (g) excludes NGC from engaging in any activities other than those specified in this section. Subsection (3)

excludes liabilities of NGC from extending it to landowners and provincial governments, although these parties are beneficiaries of NGC.

During the first LNG development forum conducted from 30 April to 20 May 2009 in Kokopo, Eastern New Britain Province, between the National Government on the one hand, and Huli landowners and Southern Highlands, Fly River, Central and Gulf Provincial Governments on the other, these legislative provisions were overlooked. Petroleum and Energy Minister William Duma, Public Enterprises Minister Arthur Somare, Finance and Treasury Minister Patrick Prutaitch and National Planning Minister Paul Tienstein who represented the national government proposed that the functions of NGC would be transferred to a private company called Kroton No.2 Limited, a new company registered by the Independent Public Business Corporation (IPBC). Kroton will carry both the national government's equity as well as the equity share allotted to the 'afffected' provincial and local level governments and the landowners. According to media reports, Kroton is a company registered in Brussels, Belgium, whose shareholders are unknown.[46] 'Affected' Huli landowners demanded 10 percent equity but the national government offered only 7 percent.[47] Many landowners refused to sign the gas development agreement. Some were persuaded, coerced or unduly influenced to sign. Mr. Alfred Kaiabe, Chairman of the NGC, and Petromin, a company the national government established to act as PNG's national oil and mineral company, were disappointed with the outcome. While the forum has cost the national government approximately K12 million in accommodating and feeding over 2,000 landowners plus

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[46] Peter Korugl, 'Kroton to Carry Govt Share', *Post Courier* (Port Moresby, Thursday 21 May 2009.
[47] Ibid.

government ministers and their support staff, the outcome was a total disaster. Many dissatisfied landowners are at this time of writing (30 May 2009) seeking court orders to overturn the agreement on the grounds, among others, that the forum was conducted without undertaking social mapping studies and identification of 'affected' landowners as required by the *Oil and Gas Act 1998*, and that Kroton is not an authorised entity, as opposed to NGC and Petromin, to carry the State's equity as well as the equity of the 'affected' landowners and the provincial and local level governments.

Just as the privatisation of MRDC and Orogen Minerals Limited extinguished the hope of Papua New Guineans to allow national companies to dominate PNG's natural resources industry, NGC and Petromin that carry the hope of becoming truly Papua New Guinean companies participating in the upstream and downstream sectors of the extractive industries have been overlooked and rejected at the gas development forum. Just as the clear dictates of the law to form the EIC to implement the Moran development agreement has been overlooked, so did the national government bypass the provisions of section 179 of the *Oil and Gas Act 1998* to allow the NGC to be the trustee of the national government and 'affected' beneficiaries to carry their equity in the gas project. As a consequence of such political failures of successive governments to act within the clear dictates of the relevant laws and regulations, the current BSR is leading the country towards economic subjugation and underdevelopment.

III. POLICY SOLUTIONS

This thesis suggests two alternative policy solutions to the current BSR. First, project benefits should be shared with customary landowners not because they are 'affected' as is done under the current regime, but because they are owners of the mineral or petroleum beneath their land. After all, this is the view that most landowners hold. Restoring customary ownership would provide a more cogent reason for providing the cash and non-cash benefits under the BSR than on the basis that they are 'affected'. If 'affected' is the only basis for sharing project benefits with some landowners, then other 'affected' landowners outside the borders of a mining lease or a petroleum development licence would be justified to claim the same benefits on the basis that they too are 'affected'. To prevent this sort of construction, restoring customary ownership would provide a more legitimate and cogent reason for the government's discriminatory benefits-sharing practice.

Alternatively, this thesis strongly suggests that comprehensive legislation should be introduced to overhaul the current mining and petroleum regimes to expressly state that, in order to give effect to the constitutional objectives entailed in the NGDPs, Papua New Guineans must own 51 percent or more of the equity in all mining and petroleum projects in the country irrespective of their size. To achieve this, the national government should abolish its equity participation policy in petroleum and mining projects. Instead of the State, private citizens must be allowed and facilitated to hold majority of the shares in the country's mineral and petroleum projects. After all, Great Britain, the United States and Australia, for examples, became industrialised and prospered when their own citizen

companies exploited the natural resources in their respective countries. For instance, public opposition against ChinalCo's proposed 18 percent acquisition in Rio Tinto of Australia in 2008-2009 highlights this position.[48] Just as Australia is not prepared to allow a foreign corporation to acquire 18 percent in Rio Tinto, or Quantas to merge with British Airways, or other Australian corporate icons to be taken over by foreign firms, so too must PNG.[49] PNG companies owned by Papua New Guineans must develop PNG's rich mineral ore deposits and oil and gas reserves. This thesis suggests that the Australian practice is the practice PNG should follow in order to avoid the resource curse and set itself on the path to economic independence.

For so long as PNG has a majority private foreign ownership and control of its extractive industries as it is today, and then plays politics with its minor 22.5 percent in petroleum and 30 percent in minerals projects, the country is heading for economic disaster. Moreover, the current BSR that promotes and protects foreign investment by appeasing a select few landowner elites and political leaders is likely to backfire and lead to resource wars like the one at Bougainville. This thesis hopes that that does not happen, as leaders think sensibly and direct the development of natural resources as envisaged by the NGDPs.

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[48] In 2008-2009, the ACTU opposed the proposed sale of 18 percent shares in Rio Tinto to ChinalCo. A private businessman in Victoria even took out television advertisement against the Rudd Government from selling Australia's 'strategic resources' to China in May-June 2009. The passion against majority foreign ownership of Australia's minerals and petroleum is very strong. Although 18 percent is nowhere near majority ownership, it indicates how industrialized countries jealously protect their own mineral and petroleum from foreign ownership.

[49] The Australian Government refused to approve Qantas' proposal to merge with British Airways in 2008. Other industrialized countries do the same to protect their corporate icons.

IV. CONCLUSION.

This chapter shows that PNG’s resource curse (or underdevelopment) is caused by its role as a client State of metropolitan capital through neocolonialism. The State facilitates mineral and petroleum resources exploitation by foreign capital and employs its share of the tax and equity revenues to purchase security in order to protect foreign exploitation. The chapter also establishes that local elites misuse project funds, while foreign interests influence government policy, both of which amount to corruption that serves their mutual interests. Accordingly, the PNG experience proves the assumptions of underdevelopment theory than that of the modernisation or ‘free market’ economics and resource curse theories. There is a case for PNG to rewrite its laws to give effect to the NGDPs to allow Papua New Guineans and corporations owned by citizens to have 51 percent or more shares in all mining and petroleum projects in the country. In other sectors of the economy, there is a case for PNG to adopt and pursue the policies suggested by structuralism of underdevelopment economics.

CHAPTER TWELVE

CONCLUSION

Our only real hope lies in clear, independent thinking by those not too steeped in the flawed policies responsible for our current crisis. We must see clearly that fundamental, comprehensive financial and economic reform is imperative. We must adapt that fundamental reform to our own needs…[1]

INTRODUCTION

By way of conclusion, this chapter provides a summary of the contesting theories and explanations for the poverty of natural resource-rich developing countries in the first section. In the second section, it recaptures the current trend where *transparency* and *good governance* have become the 'consumer friendly' terms replacing previous concepts such as modernisation, structural adjustment programs and Washington Consensus in orthodox Third World development discourse. The third section explores policies alternative to 'free market' policies that the now developed countries followed in order to become industrialised, which Third World countries need to adopt and follow. The final section provides a conclusion.

I. SUMMARY OF THE CONTESTING EXPLANATIONS FOR THIRD WORLD UNDERDEVELOPMENT OR THE RESOURCE CURSE

We have begun this thesis by exploring what causes Third World underdevelopment and poverty in general and the 'paradox of plenty' in Papua New Guinea (PNG) in particular. According to the modernisation discourse, one of the main causes of Third World

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[1] James Cume, *The Black Death of Financial Collapse* (10 April 2008) online at http://www.mindfully.org/WTO/2008/Financial-Collapse-Globalization10apr08.htm. <Accessed 28.07.08>. (Cumes is former Australian ambassador to the European Union and Australian representative at the United Nations. He is the author of, among other works, *The Human Mirror: The Narcissistic Imperative in Human Behaviour*).

underdevelopment was lack of capital. Capital accumulation was necessary to spur Third World industrialisation, which would eliminate poverty and usher in prosperity through sustained economic growth. The question was: where would the money come from to fund the initial industrialisation programs? Modernisation theorists pointed out that countries that were endowed with rich natural resources should begin their modernisation process by exploiting their rich natural resources. Since Third World countries did not have the technology, skills, knowledge and capital to exploit their natural resources, they should allow transnational corporations from the developed countries to exploit these resources. In the process of extracting the natural resources, transnational corporations would then be able to not only generate the money needed, but also transfer technology, knowledge and skills necessary to launch the host developing country's industrialisation program. Based on this reasoning, modernisation theorists projected that developing countries that have abundant natural resources would industrialize faster than the natural resource-poor developing countries.

Underdevelopment theory disagreed with the basic assumptions of modernisation theory. According to underdevelopment discourse, the Third World was poor and underdeveloped because the First World extracted and exploited Third World labour, land and natural resources for its enrichment. Decolonisation did not put an end to this exploitative relationship but merely relinquished administrative burdens of the colonial powers and shifted them onto the newly independent governments. Accordingly, under neocolonialism local political elites and metropolitan powers combine to extract and exploit Third World wealth for their benefit but to the detriment of the vast majority.

Resource curse theorists informed by neoliberal economics in the 1990s pointed out to the evidence that, contrary to the assumptions of modernisation theory, natural resource-poor Asian countries such as Singapore, Taiwan and South Korea steamed ahead in their industrialisation efforts compared to the natural resource-rich developing countries. In other words, their evidence vindicated the assumptions of underdevelopment theory that natural resource-rich Third World countries would be exploited and underdeveloped, but instead of agreeing with underdevelopment theorists with their explanations, the resource curse theorists posit that the natural resource-rich Third World countries are 'cursed' by the natural resources abundance. In their thesis, natural resource endowment would cause economic growth and prosperity only if these poor but resource-rich countries adopt neoliberal development policies.

This thesis has sought to critically examine the resource curse thesis (RCT) from a political economy standpoint. Having examined the competing theories of development economics, this thesis has posited that colonialism, neocolonialism and globalization were the causes of Third World underdevelopment. Our critical analysis reveals, among others, that:

- The term 'underdevelopment' and 'resource curse' describe the same political economy effect from different ideological standpoint and provide different reasons for underdevelopment or the resource curse.
- The modernisation and neoliberal development theories reflect underlying ideologies as forms of social control and continued subjugation of Third World countries, while underdevelopment theory seeks to reconstruct Western historical

relations with the Third World through the colonisation, decolonisation and globalization processes to explain Third World underdevelopment.

- While most policy solutions offered by the RCT are irrelevant to developing countries such as PNG, some are useful, especially the recommendation for private domestic ownership and control over mineral and petroleum extraction, and human education.
- First World countries do not wholeheartedly embrace free-market policies. Instead they maintain some of the world's most protective regimes that provide millions of dollars to support domestic companies and restrict the entry of foreign products into their economies, whereas developing countries are severely criticised and described as being 'cursed' for not seeking 'free-market' policies.
- Through colonisation, neocolonialism and globalization of neoliberalism, Third World wealth, instead of being accumulated, are caused to fly out of the poor countries through debt servicing, tax evasion, and other licit and illicit forms of capital flight.
- Foreign investment in the extractive industries creates very few linkages sufficient to form capital in the host developing country to set the preconditions for 'take-off' into industrialisation. While foreign direct investment (FDI) in agriculture and manufacturing may be beneficial to the host country, in the extractive industry it is not.
- Both endogenous and exogenous factors affect the development trajectories of developing countries as opposed to only endogenous factors emphasised by the resource curse discourse.
- Neoliberal policies and the Washington Consensus 'curse' developing countries.

- The RCT is an ideological discourse of neoliberalism, which blames the victims of the Washington Consensus, colonialism, neocolonialism and globalization.
- The policy solution to escape the resources curse or avoid underdevelopment is to adopt the policies that the industrialised countries like Great Britain, the United States, France, Germany, Japan, Australia and Canada followed when they were developing countries. And the policies these countries followed is not the Washington Consensus and the 'free-market' and 'free trade' policies advocated by the RCT but infant industry protection and protective policies behind strong tariff walls advocated by underdevelopment theory.

II. CURRENT TREND

The resource curse theorists explain that because resource-rich developing countries have followed autarkic policies, their economies have failed to grow and develop. 'Up until the late 1970s most developing countries had favored a statist approach to development, using economic planning, import-substitution-industrialisation, price controls, credit rationing, state-owned enterprises, and government control of agricultural marketing….'[2] The resource curse theorists recommend the abandonment of these policies and the adoption of market-friendly policies epitomised in the Washington Consensus to solve the resource curse. Since the Washington Consensus imposed in loan recipient developing countries as structural adjustment programs (SAP) by the IMF and the World Bank became unpopular, politically friendly terms like *good governance* and *transparency* have been adopted and used by these international financial institutions.

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[2] Ngaire Woods, *The Globalizers: The IMF, the World Bank and their Borrowers* (2006) p.142.

Today *transparency* and *good governance* have been infused into the objectives and programs of prominent global civil society groups.[3] Behind the veil of the civil society groups, the resource curse thesis became the bandwagon upon which neoliberal ideology ride into the economic policy boardrooms of resource-rich developing countries. For instance, Jeffrey Sachs, the Harvard economic guru of privatisation responsible for Russia's privatisation program that caused the transfer of public wealth into the hands of a few oil oligarchs, joined with Bono, the rock star from the band U-2, to sell the idea that global poverty can be ended in their lifetime.[4] Using celebrities to sell unpopular economic policies, Loretta Napoleoni argues, not only trivializes but also cushions the painful consequences of the Washington Consensus, which she describes as 'the politics of rogue economics'.[5] With specific reference to the *End Poverty* campaign spearheaded by Bono, Napoleoni points out that:

> Two years from the historic decision to scrap the African debt, the continent has become poorer than ever. None of the new initiatives have helped, including RED, the pool of companies gathered by Bono, which dedicates a percentage of their sales to help Africa. All they have achieved is a free publicity for their own brands. The "End Poverty" fiasco outlines the limitations of celebrities, even when they are well intentioned, when they enter the political arena. They are ill-informed and often lack the scientific and professional background to understand complex issues, such as poverty in Africa, but above all they fall easy prey to the greater performers, politicians and their Machiavellian marketing machines.[6]

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3 For details on criticism of the SAPs, see Woods, ibid.

4 Sachs has now become special economic advisor to the United Nations' Secretary General, and is now travelling the developing world preaching sustainable development and ending poverty. On 16 July 2008, he was in Port Moresby for just two hours before he moved on. Distinguished persons from both the public and private sector including the prime minister packed the University of PNG Lecture Theatre to listen to him.

5 Loretta Napoleoni, *Rogue Economics: Capitalism's New Reality* (2008) pp.210-211; see also pp.197-197.

6 Id., at p.198.

Indeed, *transparency* and *good governance* are useful concepts that are being employed as marketing concepts of neoliberalism and neocolonialism in order to avoid public opposition. Just as *democracy* and *free market capitalism* have become synonymous after the fall of the Berlin Wall and capitalism's victory over communism, and the Third Way has closed the traditional political demarcation between Left and Right,[7] *transparency* and *good governance* have merged the competing theories of development and promise to resolve Third World underdevelopment. *Transparency* and *good governance* have also merged the science of politics and economics, making obsolete traditional intellectual conflicts in development discourse.[8] One consequence of this merger, according to Mark Neocleous, is that the Left is 'getting more and more conservative in trying to hold on to the established welfare state, …the traditional conservatives, the Right, to a large extent, have turned into neo-liberals arguing in favour of free market and thereby contributing to the erosion of tradition.'[9] Consequently, any developing country aspiring to promote development and economic growth is presented with the *one-size-fits-all* Washington Consensus.

This study has pierced through the veil of the RCT to expose the neoliberal agenda behind it. It has argued that inanimate resources have no cognitive function by which to curse resource-rich developing countries. Instead, the resource curse is a misnomer for accumulation by dispossession.[10] Since the resource curse occurs only in resource-rich developing countries, accumulation by dispossession is obviously evident. Accumulation

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[7] Ibid.

[8] Id., at p.208.

[9] Mark Neocleous, 'Radical Conservatism, or the Conservatism of Radicals: Giddens, Blair and the Politics of Reaction', (1999) 93 *Radical Philosophy* pp.24-34; See also Mark Neocleous, *The Monstrous and the Dead: Burke, Marx, Fascism* (2005).

[10] A useful history on the rise of this exploitative capitalism is provided by Robert W. Cox, *Production, Power and World Order: Social Forces in the Making of History, Volume 1 in the four-volume series on Power and Production* (1987).

by dispossession was carried out in the Third World through imperialism and colonialism, and continues today through neocolonialism and globalization of the Washington Consensus. The effect of accumulation by dispossession is poverty in the midst of resource abundance. Since the Spanish discovery of the Americas in 1492 and its subsequent subjugation of the continent, and later the subsequent waves of European colonial conquest of Africa, Asia and Oceania, the capitalist intent to exploit and siphon off the natural wealth of the subjugated territories to Europe, and create markets for their industrial products has hardly changed. Globalization of neoliberalism has since exacerbated exploitation to such an extent that *nation-states* have now become *market-states*, consequently increasing world poverty.[11] Market-states employ both political and military powers to facilitate the advancement of economic progress to benefit the ruling elites of world capitalism. Accordingly, law, politics and economics have become instrumental triplets of economic exploitation for the world's capitalist elites.

III. ALTERNATIVE POLICIES TO LIFT THE RESOURCE CURSE

This thesis has established that the only *historically proven* way to avoid underdevelopment or the resource curse is to copy and follow the development policies of Australia, the United States, Canada, Japan, France, Germany and Great Britain when they were developing countries. What set of economic policies did these countries follow to become developed? Ha-Joon Chang provides the answer to this question in his *Kicking Away the Ladder: Development Strategy in Historical Perspective* published in 2003.[12] Chang examines the great pressure applied to developing countries by the developed world to adopt certain 'good policies' and 'good institutions', seen today as

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[11] For details on market-states, Napoleoni, above n5. See also Noreena Hertz, *The Silent Takeover: Global Capitalism and the Death of Democracy* (2001).

[12] Chang's book is a *must read book* for any developing country that is serious about development and progress.

necessary for economic development. Chang shows that these so-called 'good policies' and 'good institutions' were not the ones that the now developed countries (NDCs) followed when they were at the developing stage. From an historical survey, Chang finds that the economic evolution of the NDCs differed dramatically from the policies and procedures that they recommend to developing countries. He concludes that the NDCs are attempting to 'kick away the ladder' by which they have climbed to the top, thereby preventing developing countries from adopting policies and institutions that they themselves used. As Chang then observes:

> The picture that emerges from our historical survey seems clear enough. *In trying to catch-up with the frontier economies, the NDCs used interventionist industrial, trade and technology policies in order to promote their infant industries.* The forms and emphasis of these policies may have been varied according to different countries, but there is no denying that they actively used such policies. In relative terms (that is, taking into account the productivity gap with the more advanced countries), *many of them actually protected their industries far more strongly than the currently developing countries have done*.[13]

Chang goes on to argue that the currently recommended 'free trade' and *laissez-faire* industrial, trade and technology policies as 'good policies' are at odds with historical experience. The NDCs did not succeed on the basis of the Washington Consensus, but precisely on the basis of those policies that they recommend the developing countries not to follow. Chang critically explores the following issues:

- Are the developed countries, and the international development policy establishment (IDPE) that they control, recommend policies that they find

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[13] Ha-Joon Chang, *Kicking Away the Ladder: Development Strategy in Historical Perspective* (2003) pp.127. Emphasis added.

beneficial for themselves, rather than those beneficial for the developing countries?

- Is there any parallel between this and the nineteenth-century British push for free trade against the protectionist policies of the USA and other NDCs which were trying to catch up with it?
- Is it fair to say that the WTO agreement that puts restrictions on the ability of the developing countries to pursue activist ITT policies is only a modern, multilateral version of the 'unequal treaties' that Britain and other NDCs used to impose on semi-independent countries?
- In other words, are the developed countries 'kicking away the ladder' by which they climbed up to the top beyond the reach of the developing countries?

He then answers: '*The answer to all these questions, unfortunately, is yes.*'[14]

The economic policies that the NDCs adopted are the very import-substitution-industrialisation and infant industry protection policies that the resource curse theorists condemn as being 'bad'. In Great Britain, from King Edward III (1312-1377), who promoted local wool clothing manufacturing by wearing only English cloth to the infant industry promotion policies of the Tudor monarchs, especially Henry VII (1485-1509) and Elizabeth I (1533-1603), who transformed England from raw-wool exporter into the most formidable woolen manufacturing nation, England had always protected its infant industries behind high tariff barriers. By the time of Elizabeth (1587), Britain was so confident about its woolen textile industry's international competitiveness that it totally banned raw wool export. It is quite clear that 'without the infant industry promotion

[14] Id., pp.127-128. Emphasis added.

strategy put in place by Henry VII and further pursued by his successors, it would have been very difficult, if not necessarily impossible, for Britain to make this initial success in industrialisation…. And without this key industry, which accounted for at least half of its export revenue during the 18th century, its Industrial Revolution may have been next to impossible.'[15] Britain's industrial development took a great leap after the 1721 reform of the mercantile law introduced by Robert Walpole, first British prime minister during the reign of King George (1660-1727). Walpole's 1721 legal reform, and subsequent supplementary policy changes, introduced the following measures:

- Dropped or lowered import duties on raw materials used for manufactures.
- Duty drawbacks on imported raw materials for exported manufactures were increased.
- Abolished export duties on most manufactures.
- Increased duties on imported foreign manufactured goods.
- Provided government subsidies to new export items like silk products and gunpowder, and increased subsidies of existing subsidized export goods like sailcloth and refined sugar.
- Introduced quality control regulations to prevent unscrupulous manufacturers from damaging the quality and reputation of British products in overseas markets.[16]

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[15] Ha-Joon Chang, 'Infant Industry Promotion in Historical Perspective – A Rope to Hang Oneself or A Rope to Climb With?' (Paper presented at the conference *Development Theory at the Threshold of the Twenty-first Century*, ECLAC, Santiago, Chile, 28-29 August 2001)p.6.

[16] Chang, id., at p.7. For details on these policies, see R. Davis, 'The Rise of Protection in England, 1689-1786' (1966) 19 (2) *Economic History Review* p.314; J. McCusker, 'British Mercantilist Policies and the American Colonies' in S. Engerman and R. Gallman (eds.), *The Cambridge Economic History of the United States, Vol.1: The Colonial Era* (1966) p.358; and N. Brisco, *The Economic Policy of Robert Walpole* (1907) pp. 131-3; 148-55; 169-71.

Similar policies like these were followed by the Asian countries, Japan, South Korea, and Taiwan during the postwar period, which consequently placed them on the right path to industrialisation.[17]

The repeal of the Corn Laws in Britain, cited by supporters of *laissez faire* capitalism as proof of their position is 'probably better understood as an act of *'free trade imperialism'…intended to 'halt the move to industrialisation on the Continent by enlarging the market for agricultural produce and primary materials…'*.'[18] To prevent industrialisation in other parts of Europe and her colonies, Britain removed most of its tariffs only after 1860, but these were reintroduced in 1932 when it lost its manufacturing hegemony. '*Thus seen, contrary to the popular belief, Britain's technological lead that enabled this shift to a free trade regime had been achieved 'behind high and long-lasting tariff barriers'….*'[19]

More than Great Britain, the United States, dubbed as *'the mother country and bastion of modern protectionism'* developed as a result of government protection of infant industries behind high tariff walls.[20] As well as tariff protection, the U.S. government employed other policies to promote the country's economic development such as support for agricultural research, government land grants, setting up research institutes, investments in agricultural chemistry, general education and training, promotion of transportation and infrastructure, and substantial subsidies for defence-related procurement, and research

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17 Chang, above n13, pp.7-8.
18 Chang, id., at p.10. Emphasis added.
19 Paul Bairoch, *Economics and World History – Myths and Paradoxes* (1996) p.46, cited in Chang, above n13, at p.11. Emphasis added.
20 Id, p.30. Emphasis added.

and development which had enormous spill-over effects.[21] Even to this day, it is federal government spending that gives industries such as computers, aerospace and the internet, and defence-related corporations an international edge in a competitive world. '*Boeing would not be Boeing, nor would IBM be IBM, in either military or commercial endeavours without Pentagon contracts and civilian research support.*'[22] The critical role of the U.S. government in funding the National Institutes of Health (NIH) in supporting research and development in pharmaceutical and biotechnological industries, which accounts for 29 percent while the industry meets only 43 percent also demonstrates the importance of government support in the economy.[23]

In academia, the U.S. produced economists and political scientists who advocated infant industry protection and high tariff barriers, but these have been erased from economic textbooks. As Chang reveals:

> During the nineteenth century, the USA was not only the strongest bastion of protectionist policies, but was also their intellectual home. At that time it was widely believed among US intellectuals that 'the new country required a new economics, one grounded in different political institutions and economic conditions than those prevailing in the Old World.' Some of them went so far as to argue that even internationally competitive US industries should have tariff protection because of the possibility of predatory dumping by large European enterprises, who, after decimating the American firms, would revert to monopolistic pricing.
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> Well into the last quarter of the nineteenth century, most of the more original US economists of the period seemed to have been strong advocates of infant industry protection. The well-known supporters of infant industry promotion, Daniel Raymond (who influenced Friedrich List) and Matthew Carey were the two leading economists of

21 H. Shapiro and L. Taylor, 'The State and Industrial Strategy' (1990) 18 (6) *World Development* p.866; See also G. Owen, *Industry in the USA* (1966).
22 Shapiro and Taylor, id., at p.866. Emphasis added.
23 Chang, above n13, at p.31.

> the early nineteenth century, while American economics during the mid-to late nineteenth century was dominated by Carey's son Henry. Henry Carey was described as 'the only American economist of importance' by Marx and Engels in the early 1850s and was one of Lincoln's…economic advisors. Unfortunately, most of these economists have now been airbrushed out of the history of US economic thought, but it was they, rather than the American Classical economists…who were the more prominent intellectual figures of the time.[24]

Chang points out that many U.S. intellectuals and politicians during the country's development clearly understood that the free trade theory advocated by the British Classical Economists was unsuited to their country. Therefore, intellectual giants like 'Henry Carey, the most prominent protectionist politician of the early nineteenth century and Abraham Lincoln's early mentor, named his economic policy platform the 'American System', in explicit opposition to what he called the 'British System' for free trade. Somewhat later, Henry Carey even argued that free trade was part of British imperialist system that consigned the USA to a role of primary product exporter.'[25]

Like Great Britain and the United States, other NDCs also pursued protectionist policies. Today's rich countries protected their nascent producers by restricting foreign investment. Again, as Chang reveals:

> In the 19th century, the US strictly regulated foreign investment in banking, shipping, mining and logging. Japan and Korea severely restricted foreign investment in manufacturing. Between the 1930s and the 1980s, Finland officially classified all firms with more than 20 per cent foreign ownership as 'dangerous enterprises'. … The Netherlands and Switzerland refused to protect patents until the early 20th century. In the 19th century, most countries, including Britain, France, and the US explicitly allowed

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[24] Change, above n13, at pp.31-32.
[25] Ibid.

patenting of imported inventions. The US refused to protect foreigners' copyrights until 1891. Germany mass-produced counterfeit "made in England" goods in the 19th century.

Despite this history, since the 1980s the "Bad Samaritan" rich countries have imposed upon developing countries policies that are most exact opposite of what they used in the past. But these countries condemning tariffs, subsidies, public enterprises, regulation of foreign investment, and permissive intellectual property rights is like them "kicking away the ladder" with which they climbed to the top – often against the advice of the then richer countries.[26]

We now know that the alternative policy for developing countries is to restrict foreign investment in the extractive industries and pursue protectionist policies and abandon the free trade and free market policies that have been forced upon developing countries over the last three decades. The stakes are in favour of governments of developing countries playing a greater role in the economic development of their countries by promoting local productivity through subsidies and infant industry protection policies. Chang's finding that it is the active involvement of governments in industrial, trade and technology that was responsible for the industrialisation of Japan and the resource-poor but fastest industrialising economies of East Asia is worth noting:

> There has long been an ideologically-charged debate about the causes of the economic 'miracle' in postwar Japan and East Asia NICs [newly industrializing countries] over the last two or three decades. Despite some lingering disagreements, there is now a broad consensus that the spectacular growth of these countries, with the exception of Hong Kong, is fundamentally due to activist industrial, trade and technology (ITT) policies by the state.[27]

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[26] Ha-Joon Chang, 'Protectionism…the truth is on a $10 bill', in *The Independent*, Monday, 23 July 2007, online at http://www.independent.co.uk/news/business/comment/hajoon-chan... <Accessed 30.07.08>. Emphasis added.

[27] Chang, above n13, at p.49.

The East Asian economies followed the Western protectionist policies with modifications to suit the changing times and their unique cultural, social and political environments. For instance, they integrated human-capital-related and learning-related policies into their industrial policy framework through 'manpower planning' that is far more tight than that of the U.S. or Britain.[28] Foreign direct investment was controlled to ensure that technology was transferred in a more practical and systematic way.[29] Serious attempts were made to upgrade these countries' skills base and technological capabilities through subsidies to education, training and research.[30] The resource curse thesis has twisted this historical fact and interprets Asian industrialisation as a result of pursuing 'free market' policies.

Based on these proven historical records, developing countries such as PNG would do well to abandon the market-friendly policies imposed by donor agencies and international financial institutions in favour of autarkic and government-led development policies. There is another reason, and perhaps more compelling reason, why the market-friendly policies of neoliberalism must be rejected: *it has not worked*. There is overwhelming evidence that market-friendly policies of the last 30 years have not worked.[31] For instance:

> Growth has failed particularly badly in Latin America and sub-Saharan Africa, where neo-liberal reforms have been implemented most thoroughly. In the "bad old days", per capita income in Latin America grew at an impressive 3.1 per cent per year. In the

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[28] See Jong-Il You and HJ Chang, 'The Myth of Free Labour Market in Korea' (1993) 12 (1) *Contributions to Political Economy* pp.29-46.

[29] Ha-Joon Chang, 'Globalization, Transnational Corporations, and Economic Development' in D. Baker, G. Epstein and R. Pollin (eds), *Globalization and Progressive Economic Policy* (1998).

[30] L. Kim, 'National System of Industrial Innovation: Dynamics of Capability Building in Korea' in R. Nelson (ed.), *National Innovation Systems* (1993), and other articles in that book. See also Chang, above n13, at p.50.

[31] Woods, above n2; Herts, *The Silent Takeover*, above n11; Mike Davis, *Planet of Slums* (London and New York: Verso, 2006).

> "brave new world", it has been growing at a paltry 0.5 per cent. In sub-Saharan Africa, per capita income grew at 1.6 per cent per year during the 1960-80, but since then the region has seen a fall in living standards (by 0.3 per cent a year).[32]

There is no doubt that '*trade liberalization…principally benefit the firms of the developed countries of the world, since they are the most technologically advanced.*'[33] The '*post-1980 neoliberal era has been marked by slower growth, greater trade imbalances, and deteriorating social conditions*.'[34] As the United Nations Conference on Trade and Development (UNCTAD) reports, 'for developing countries as a whole (excluding China), the average trade deficit in the 1990s is higher than in the 1970s by almost 3 percentage points of GDP, while the average growth rate is lower by 2 percent per annum.'[35] Therefore, '*contrary to popular belief, the past 25 years (1980-2005) have seen a sharply slow rate of economic growth and reduced progress on social indicators for the vast majority of low-and middle-income countries [compared to pre-neoliberal decades].*'[36]

The inescapable conclusion is that market-friendly policies have indeed cursed developing countries by making them poorer than they were before. '*Both the history of the rich countries and the recent records of developing countries point to the same conclusion.* ***Economic development requires tariffs, regulation of foreign investment,***

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[32] Chang, *The Independent*, above n25.

[33] Anwar Shaikh, 'Globalization and the Myth of Free Trade' (Paper presented at the *Conference on Globalization and the Myths of Free Trade* at New School University, New York, 5 April 2003) p.10. Emphasis added.

[34] Martin Hart-Landsberg, 'Neoliberalism: Myths and Reality' (April 2006) 57 (11) *Monthly Review* pp.1-15, at p.7. Emphasis added.

[35] UNCTAD, *Trade and Development Report 1999* (1999) p.vi.

[36] Mark Weisbrot, Dean Baker and David Rosnick, *The Scorecard on Development: 25 Years of Diminished Progress* (Washington D.C.: Centre for Economic and Policy Research, 2005) p.1. Emphasis added. See also (by the same authors) *The Relative Impact of Trade Liberalization on Developing Countries* (Washington D.C.: Centre for Economic and Policy Research, 2002).

***permissive intellectual property laws, and other policies that help their producers accumulate productive capabilities*.'[37]

V. CONCLUSION

From the resource curse discourse the most prominent solutions to combat the resource curse include the following:

- Implementation of sound fiscal and monetary policies, such as the accumulation of budget surpluses and avoidance of large-scale foreign debt to insulate the domestic economy from volatility of commodity revenues.[38]
- Promotion of economic diversification to prevent the booming export sector and the non-traded goods sector, including retail, services, and construction, from crowding out the non-booming export sectors.[39]
- Establishment of natural resource funds, either to reduce the impact of commodity price volatility on the economy and thereby improve budget predictability (stabilization funds) or to ensure that a share of the wealth will exist for future generations after the natural resources are depleted (savings funds).[40]

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37 Chang, *The Independent*, above n25. Emphasis added.

38 For examples, Menachem Katz, Bartsch Ulrich, Harinder Malothra, and Milan Cuc, *Lifting the Resource Curse: Improving Petroleum Revenue Management in Sub-Saharan Africa* (2004), and Raymond F. Mikesell, 'Explaining the Resource Curse with Specific Reference to Mineral Exporting Countries' (1997) 23 (4) *Mineral Resources Policy* pp.191-99.

39 Ricardo Hausmann and Roberto Rigobon, 'An Alternative Interpretation of the Resource Curse: Theory and Policy Implications' in J. Davis, R. Ossowski and A. Fedelino (eds), *Fiscal Policy Formulation and Implementation in Oil-Producing Countries* (2003) pp.13-44 Maria Sarraf and Moortaza Jiwanji, 'Beating the Resource Curse: The Case of Botswana' (Environmental Economic Series Paper No. 83, Washington D.C.; The World Bank, 2001).

40 Jeffrey Davis, Ronaldo Ossowski, James Daniel and Steven Barnett, 'Stabilization and Savings Funds for Non-renewable Resource Experience and Fiscal Policy Implications' in J. Davis et al., ibid, pp.273-315.

- Improvement of transparency, accountability, and public involvement in the decision-making process to address the political effects of mineral wealth, namely corruption, rent-seeking, and authoritarian regimes.[41]
- Direct distribution to the population to elicit public participation and deciding how mineral wealth is spent and overseeing its utilization.[42]

This study however recommends that ownership of the means of production – wealth producing natural resources – be vested in the citizens of resource-rich developing countries like PNG. This recommendation is based on the undisputed fact that capital accumulation is possible for only those who own and control the wealth-producing resources. The legal explanations for the occurrence of the resource curse, and the PNG experience show that, firstly, a resource-rich developing country must protect the property rights in natural resources owned by its people. To do this, the government of a developing country like PNG must ensure that majority of the shares (i.e. 51 percent or more) are owned by citizens of the country. Such a government must ensure that private domestic corporations own, control and extract the natural resources in its country. Secondly, governments of developing countries must provide subsidies and put in place protective tariffs, and other legal, fiscal and regulatory measures designed to protect and promote domestic corporations into internationally competitive corporations. After all, these are the very policies that the now developed countries followed to eventually become industrialised. These are the policies (opposed by the RCT, but promoted by underdevelopment economics) that the poor but natural resource-rich developing countries should follow.

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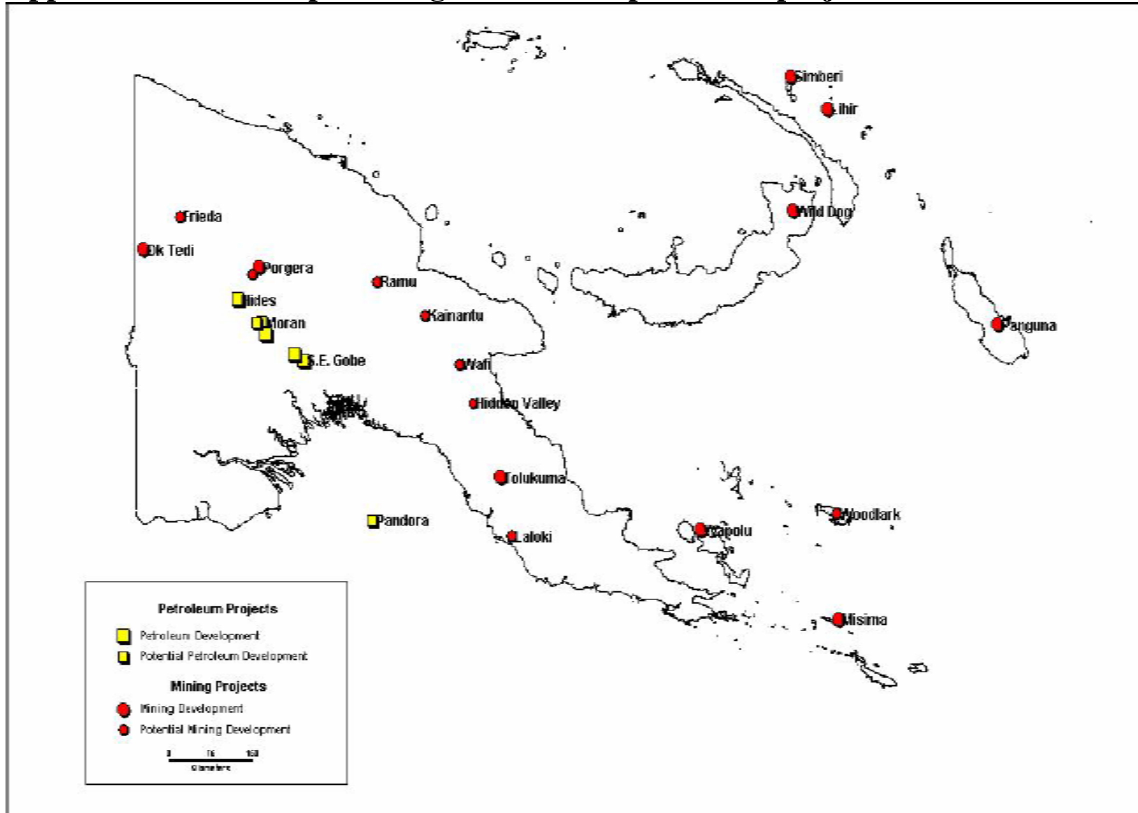
Appendices

Appendix 1 – Satellite Map of Papua New Guinea

Source: Google

Appendix 2 - Political map of Papua New Guinea showing provincial boundaries.

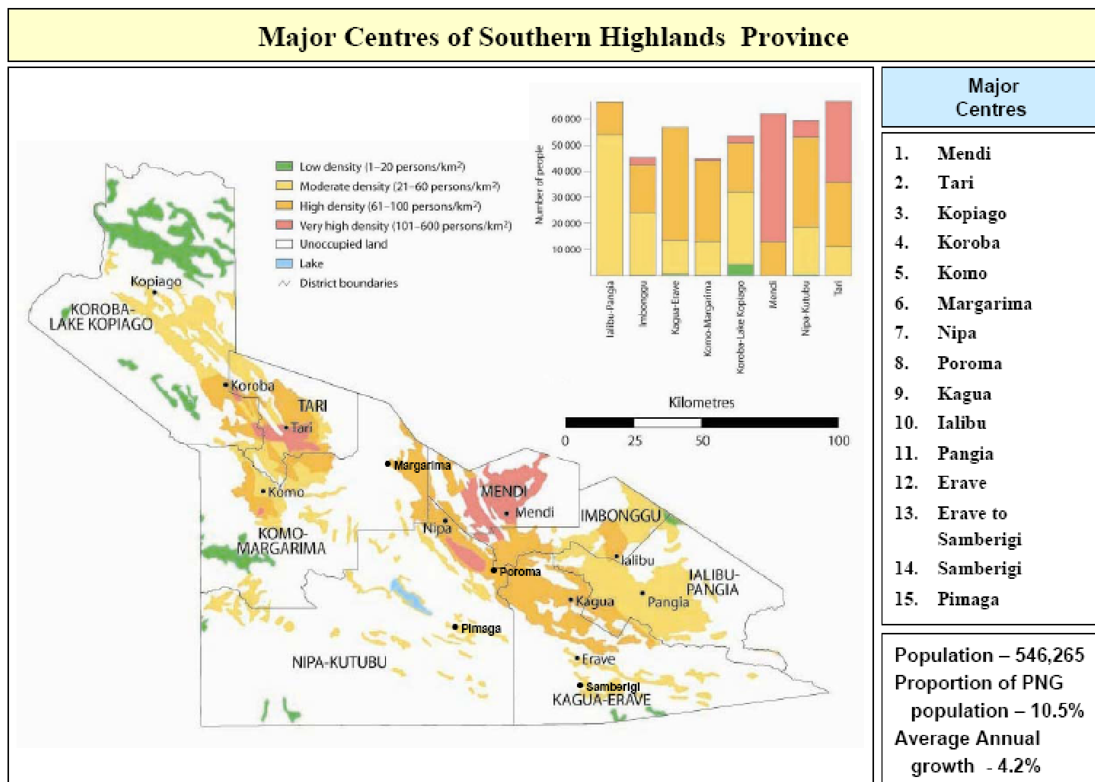
Appendix 3 - PNG map showing mineral and petroleum projects



Appendix 4 – Map of Bougainville indicating location of the Panguna Copper Mine

Source: Microsoft

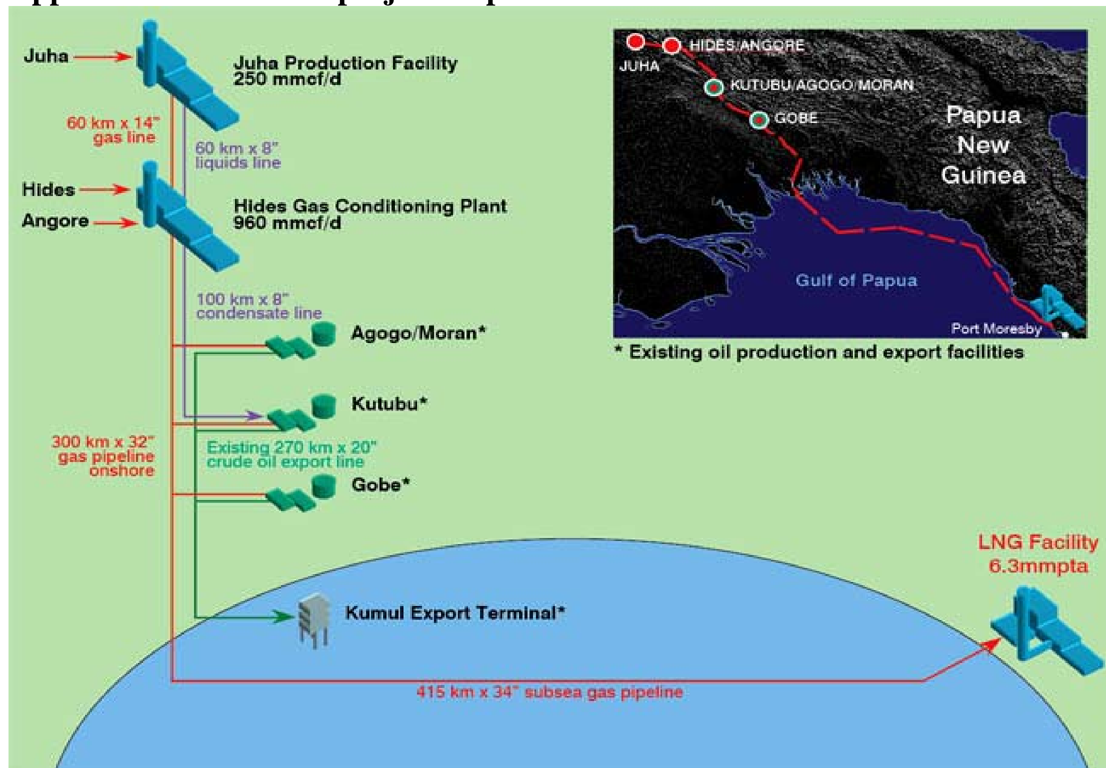
Appendix 5 - Political and Demographic Map of Southern Highlands



Appendix 6- Language map of Southern Highlands

Source: http://www.sil.org/pacific/png/show_maps.asp?map=SHP. <Accessed 07.08.09>.

Appendix 7- PNG LNG project map

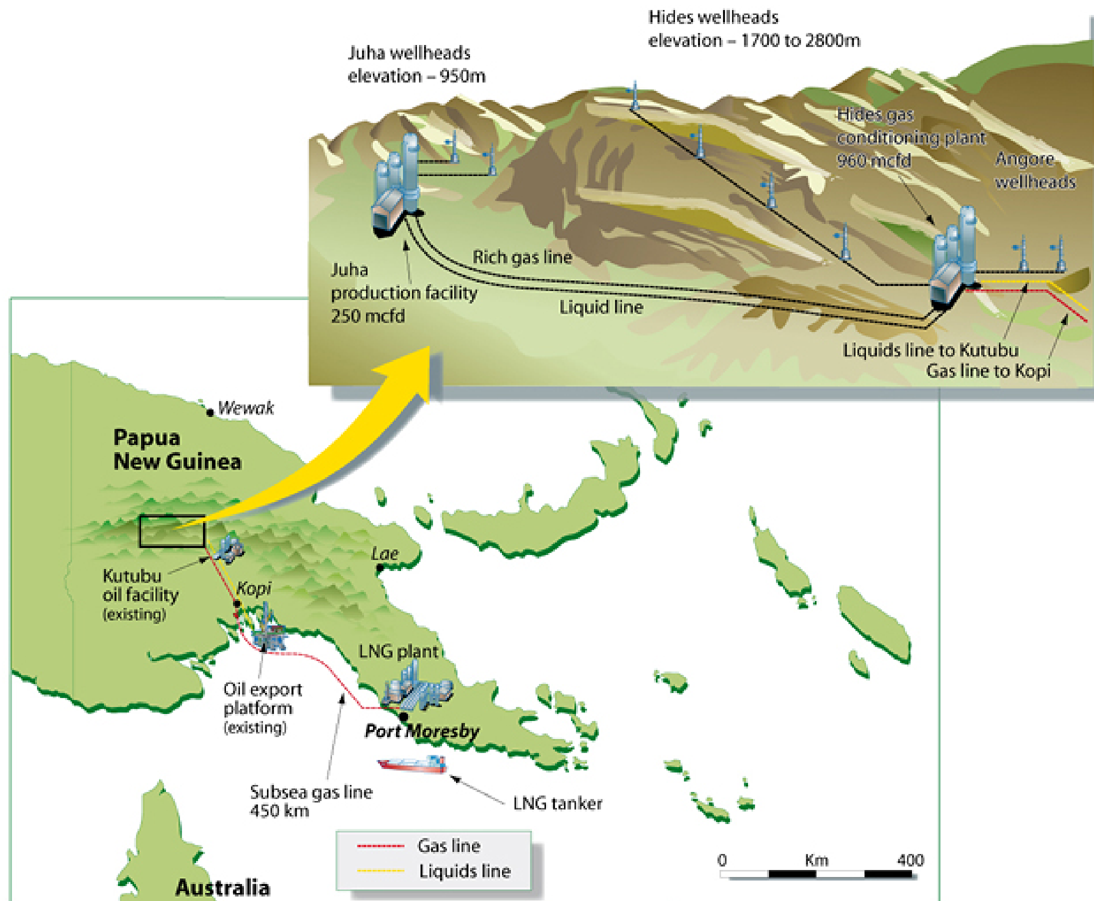


Source: Oil Search at http://www.oilsearch.com/Our-Activities/PNG-LNG-Project.html. <Accessed 06.08.09>.

Appendix 8 - PNG LNG project location map

Source: Oil Search at http://www.oilsearch.com/Our-Activities/Location-Maps.html. <Accessed 05.08.09>.

Appendix 9 – Map of PNG LNG pipeline to the LNG plant



Source: ExxonMobile at http://www.pnglng.com/project/artists.htm. <Accessed 05.08.09>.

Appendix 10 - PNG map showing location of gas reservoirs

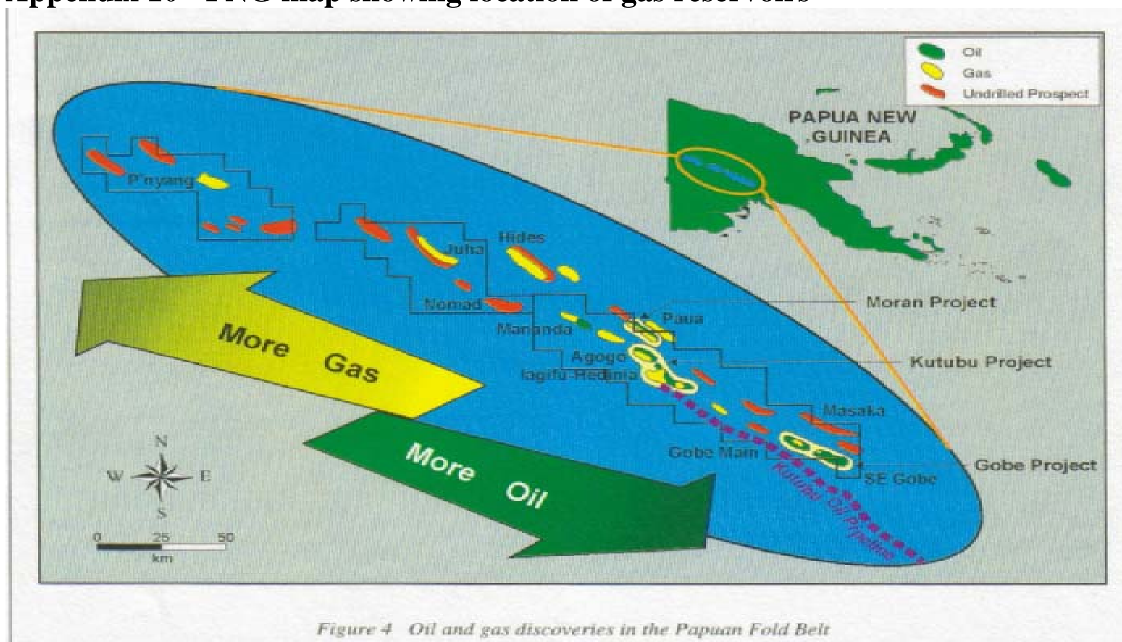


Figure 4 Oil and gas discoveries in the Papuan Fold Belt

Source: Oil Search

Appendix 11 – Map showing some of villages the gas pipeline will pass through on its way to the LNG plant

Source: Microsoft

Appendix 12- Map of oil and gas pipeline route

Source: Oil Search

Appendix 13 – Photo showing parts of the rough highlands terrain described as 'broken bottle' country.