Response

Matthew Genasci & Sarah Pray, Extracting Accountability: Implications of the Resource Curse for CSR Theory and Practice

Alex Kardon†

Matthew Genasci and Sarah Pray argue that the best cure for the "resource curse" in developing nations is increased transparency through compliance with the Extractive Industries Transparency Initiative (EITI). This argument is composed of two distinct claims. First, Genasci and Pray claim that the root cause of the resource curse is the lack of government accountability that results from reliance on resource rents rather than popular taxation for most government revenue. Second, they contend that increased transparency in the flow of funds to governments of resource-rich developing nations from corporations involved in the extraction of resources is the best way to increase government accountability.

While there is persuasive evidence that low government accountability is at the heart of the resource curse, the link between this claim and identifying transparency as the best solution is tenuous. Achieving transparency may not cure the curse where civil society is not strong enough to convert information into accountability. Since a relative lack of taxation is behind the accountability deficit, a solution involving increased taxation might be best. I propose such a solution: taxed distributions of

† B.A. 2007, Columbia University; J.D. candidate (2010), Yale Law School. The author would like to thank all the other Editors of the Yale Human Rights and Development Journal for their hard work, enthusiasm, and camaraderie.

2. Id. at 44.
3. Id. 51.
4. Id. 44.
funds directly from extracting corporations to citizens of resource-cursed nations.

I. TAXATION, ACCOUNTABILITY, AND THE RESOURCE CURSE

There is ample support in the theoretical literature for the claim that low government accountability is a central feature of the resource curse. This theoretical support is corroborated empirically. Evidence shows that only the combination of resource abundance and poor government institutions, not abundance alone, correlates with slowed economic growth. Countries with better institutions when resources are extracted will not suffer economically, while countries with poorer institutions will suffer because resource abundance will result in even worse institutions. Specifically, since democratic accountability correlates with the share of government revenue arising from taxation, poorer governments degrade when presented with newfound resources because the decreased role of taxation undermines accountability. Genasci and Pray’s first claim is thus seemingly on solid ground.

There are, however, arguments against the importance of accountability or government institutions generally in explaining the resource curse. In a seminal paper, Jeffrey D. Sachs and Andrew M. Warner found any institutional changes wrought by resource abundance to be insignificant factors in accounting for slowed growth. The assertion

5. See, e.g., Nancy Birdsall & Arvind Subramanian, Saving Iraq From Its Oil, FOREIGN AFF., Jul. 2004, at 81 ("The most important explanation for the oil curse . . . has to do with the role natural resources play in impeding the development of a society’s economic and political institutions. . . . As for the country’s citizens, because they are not taxed, they have little incentive and no effective mechanism by which to hold government accountable."); Tarek F. Maassarani et al., Extracting Corporate Responsibility: Toward a Human Rights Impact Assessment, 40 CORNELL INT’L L.J. 135, 156-57 (2007) ("EITI is based on the understanding that revenues from oil, gas, and mining companies should serve as a powerful engine of growth in developing countries, sustaining livelihoods and alleviating poverty. Unfortunately, a lack of accountability and transparency almost certainly leads to corruption, conflict, and poverty."); Martin E. Sandbu, Natural Wealth Accounts: A Proposal For Alleviating the Natural Resource Curse, 34 WORLD DEV. 1153, 1156 (2006) (discussing the support for the view that “the nefarious consequences of natural resource abundance work through its deteriorating effects on the governing institutions of the country.").
7. Id. See also Birdsall & Subramanian, supra note 5, at 83-84 (citing Norway and Botswana as two examples of strong government institutions preventing any negative growth effects from resource abundance).
9. See, e.g., Michael J. Ross, Does Taxation Lead to Representation?, 34 BRIT. J. POL. SCI. 229, 244 (2004) (demonstrating that “a rise in the price of government . . . is associated with a subsequent rise in the level of democracy”).
that decreased accountability will necessarily result from increased resources has been disparagingly labeled as “economic determinism.”

Even in countries with weak institutions, inappropriate handling of resource rents may foster dissent that demands accountability. Caution must be taken in assuming a linkage between accountability and the source of government revenue. In spite of these objections, the evidence in favor of Genasi and Pray’s first claim is substantial. The second claim is more objectionable.

II. THE PROBLEMS WITH TRANSPARENCY

Genasi and Pray are hardly alone in believing that transparency is key to curing the curse. EITI Chairman Peter Eigen expresses a common view when he suggests increased transparency would lead to greater budget accountability, improved rent allocation, poverty reduction, and eventually greater political and social stability. The World Bank apparently agrees, as evidenced by the Bank conditioning support for the Chad-Cameroon Petroleum Development and Pipeline Project on transparency. Scholars identify transparency as crucial to facilitating energy infrastructure construction in developing nations, and argue that the developed world should make this transparency an objective. Without transparency, many agree with Genasi and Pray that corruption, conflict, and poverty are almost certain to follow.

But there are two sides to this story. Even some transparency proponents fail to see EITI as the program to end the curse. EITI focuses on the revenue side of the ledger, but many feel that government

12. Id. at 297.
13. Mick Moore, Revenues, State Formation, and the Quality of Governance in Developing Countries, 25 INT’L POL. SCI. REV. 297, 299 (2004) (critically assessing “the assumption or expectation that there is a causal connection between (1) the dependence of governments on broadly levied taxes, rather than other sources of revenue, and (2) the existence of the kinds of binding constraints on governments and institutionalized political representation that constitute the foundations of liberal democracy”).
17. Id. at 5.
18. See, e.g., Maasarani et al., supra note 5, at 157 (“Unfortunately, a lack of accountability and transparency almost certainly leads to corruption, conflict, and poverty.”).
20. Extractive Industries Transparency Initiative, The EITI Criteria,
expenditures require greater oversight.\textsuperscript{21} It is also questionable whether EITI has the financial backing and leverage needed to achieve revenue transparency.\textsuperscript{22} Finally, EITI relies on nations willingly participating, and only some nations have presented themselves as willing.\textsuperscript{23} Even if transparency is the answer, EITI may not promote transparency in the right way or with the requisite collective force.

Problems with transparency run deeper than EITI. First, voluntary transparency programs in general are fraught with incentive problems. Genasci and Pray argue that the public support of institutional investors worth U.S. $14 trillion for EITI and transparency “logically enhances government incentives to improve transparency, as governments are keen to cater to the demands of potential investors.”\textsuperscript{24} As many transparency supporters accept, however, corporations have strong incentives to agree to non-disclosure demands made by resource-rich countries,\textsuperscript{25} and unaccountable governments have equally strong incentives not to change.\textsuperscript{26} Genasci and Pray greatly underestimate the need to incentivize both companies and nations if a voluntary transparency program is going to succeed.

Some transparency supporters have not underestimated this need to incentivize openness, particularly on the side of nations.\textsuperscript{27} Debt relief, financing for energy infrastructure or trade, the threat of tougher banking regulation, and capacity-building subsidies are some incentive options transparency advocates have considered.\textsuperscript{28} However, governments in most developing nations lack the administrative capacity to create, organize, audit, and publicize a budget of resource revenues and resulting expenditures.\textsuperscript{29} Multinational institutions or the extracting corporations must provide assistance, and even the combination of an incentivized nation and assistance from the World Bank or a corporation may not be enough.

The principal problem with transparency—be it voluntary or
mandated—is that it cannot cure the curse in the absence of a strong civil society to hold the government accountable for misappropriations that are brought to light. Genasi and Pray cite low government accountability as the root cause of the curse, but transparency alone will not fill this accountability gap if the people of a nation do not do their part. As Genasi and Pray and EITI Chairman Eigen acknowledge, repressive regimes have hindered the development of civil society in many resource-rich nations. Genasi and Pray suggest that pro-EITI countries have publicly stated their commitment to working cooperatively with civil society. This may be so, but such a commitment will be fruitless if civil society is not prepared to do its part. Even a former World Bank employee does not believe multinational institutions are equipped to strengthen civil society in attempting to make transparency work, and corporations may fare no better.

The aforementioned Chad-Cameroon Pipeline Project exemplifies this problem. The Chadian government was properly incentivized with aid for infrastructure construction, the government agreed to groundbreaking levels of domestic and foreign monitoring, and the World Bank was there to help. Yet before the first drop of oil passed through the pipeline, the government spent U.S. $4.5 million of its U.S. $25 million “signing bonus” on weapons to fight a civil war. Once the oil began flowing, the revenues were used to buy an airplane for the President. Civil society development lagged behind resource extraction in Chad, and resource revenue transparency without a developed civil society failed to produce an accountable government or remedy the curse.

32. Eigen, supra note 14, at 343.
33. Genasi & Pray, supra note 1, at 51.
34. Delescluse, supra note 15, at 48.
35. Id. at 45.
36. World Bank, The Chad-Cameroon Petroleum Development and Pipeline Project, What is the Revenue Management Program?, http://web.worldbank.org/WEBSITE/EXTERNAL/COUNTRIES/AFRICAEXT/EXTREGINI/EXTCAMPIPETLINE/0, contentMDK:20519576~menuPK:2092077~pagePK:64168445~piPK:64168309~theSitePK:843238,00.html (“As a condition for its support for the project, the Bank worked with the Government of Chad to help it establish an unprecedented system of safeguards assuring that the revenues are used to reduce poverty.”).
37. Id.
38. Truelove, supra note 25, at 226.
39. Birdsall & Subramanian, supra note 5, at 85.
40. Delescluse, supra note 15, at 47.
III. NWAs: A STEP IN THE RIGHT DIRECTION

As Genasci and Pray argue, the lack of accountability central to the curse is caused by the government deriving most of its revenues from resource rents rather than popular taxation. Why, then, not use some form of taxation to solve the problem? Before addressing this question, it is helpful to consider why taxation fosters accountability.

Martin E. Sandbu convincingly argues that a primary reason taxation engenders government accountability is a psychological phenomenon known as the “endowment effect.” The basic idea is that people perceive the value of something to be greater when they are in possession of it than when they are not. Thus, people perceive the loss of value when something is taken from them to exceed the loss of value when an opportunity is missed to acquire that same thing. The literature demonstrates the prevalence of the endowment effect in various contexts.

Due to the endowment effect, people care more about money taken from them by the government via taxation than about money the government could have given to them but instead spent without ever passing it through their hands. Even an instant of possession is enough to observe a significant endowment effect. In fact, even if possession never takes place (as with income tax withholding), the contemplation of possession followed by taking yields valuation distortions. Returning to the context of resource-rich nations, the upshot of the endowment effect is that people will care more about how the government spends resource revenue if it passes through their hands and is then reclaimed by the government via taxes than if the government spends the rents without getting people involved.

Based on this understanding of the role of the endowment effect in taxation fostering accountability, Sandbu proposes a system of taxable “Natural Wealth Accounts” (NWAs) to combat the resource curse. At its core, Sandbu’s system involves the governments of resource-rich nations

41. Sandbu, supra note 5, at 1159-60.
42. Id. at 1160.
43. See, e.g., Eric J. Johnson et al., Framing, Probability Distortions, and Insurance Decisions, 7 J. RISK & UNCERTAINTY 35 (1993) (offering evidence of the existence of the endowment effect when consumers make insurance purchases); Daniel Kahneman et al., Experimental Tests of the Endowment Effect and the Conse Theorem, 98 J. POL. ECON. 1325 (1990) (demonstrating experimentally that the endowment effect persists even in market settings with opportunities to learn).
44. Sandbu, supra note 5, at 1154.
46. Sandbu, supra note 5, at 1157.
47. Id. at 1160.
distributing all resource rents evenly to citizens, and then reclaiming a percentage via taxation.\textsuperscript{49} Even in a nation without a developed civil society, individuals in such a system will care more about how the government is spending resource money. Rather than relying on transparency to increase demands for accountability even in nations without developed civil societies, Sandbu’s NWAs appeal to a fundamental feature of the human psyche to fill the accountability gap. For this reason, NWAs are a promising step toward a real cure for the curse.

One problem with NWAs is that governments of resource-rich nations presumably must agree to participate. As Sandbu acknowledges, governments currently capturing almost all resource rents without having to answer to the people may have no motivation to agree to NWAs.\textsuperscript{50} He suggests that NWAs could come to fruition after significant upheavals or revolutions, before governments have experienced the perks of exploitation, when populist leaders ascend, or by buying off entrenched exploiters with efficiency gains made by ending the curse’s hampering of economic growth.\textsuperscript{51} The first three possibilities fall far short of making NWAs a universal solution, and while the fourth offers the promise of universality, it seems far-fetched and would require either massive financial outlays by intervening institutions or the willingness of entrenched parties to wait until efficiency gains are realized to receive buyouts. Sandbu’s NWA proposal offers a brilliant basic mechanism for curing the curse, but it fails to offer a realistic solution because it identifies the wrong entities (governments of resource-rich nations) to set the mechanism in motion.

IV. A Solution: Taxed Corporate Direct Distributions

Sandbu is right that some resource rents should be distributed to people and partly reclaimed by the government via taxation, but the initial distributors should be extracting corporations, not governments. This alteration to Sandbu’s proposal reduces incentive problems. As Genasci and Pray discuss, extracting corporations already execute a number of Corporate Social Responsibility (CSR) programs in resource-rich nations.\textsuperscript{52} Some corporations likely would willingly take money spent on these programs and instead distribute it directly to the people to later be taxed by the government, and governments should happily accept this newfound revenue. A system in which extracting corporations allocate CSR money to direct distribution to people with the understanding that governments will

\begin{itemize}
\item \textsuperscript{49} Id. at 1157.
\item \textsuperscript{50} Id. at 1164.
\item \textsuperscript{51} Id. at 1163-64.
\item \textsuperscript{52} Genasci & Pray, supra note 1, at 54.
\end{itemize}
tax these distributions at their discretion capitalizes on the endowment
effect mechanism proposed by Sandbu, but repackages the mechanism so
the parties conducting the initial distributions should be more inclined to
do so. Such a system of taxed corporate direct distribution seems more
likely than transparency to actually cure the resource curse.

Sandbu identifies advantages and disadvantages of his proposal. Some
advantages and disadvantages are preserved when corporations conduct
the distributions, while others are erased. One advantage Sandbu
highlights is that allowing governments to set the tax on NWAs might
generate political discussion and pressure governments to justify higher
rates by explaining how revenue will be spent. With taxed corporate
direct distribution, this advantage would be preserved since the tax rate
would still be at the government’s discretion. Another advantage of
NWAs is that they could not do much harm even if they failed to cure the
curse. Some revenues might still be redistributed from ill-spending
governments to people, and certainly no additional money would end up
in governmental hands. With corporations doing the distributing, this
advantage would be erased, as some corporations would be taking money
previously used productively and handing it to unaccountable
governments indirectly via taxation.

An obvious concern for Sandbu’s program is its logistical difficulty, and
this is also a concern to some extent with taxed corporate direct
distribution. That being said, with corporate agents responsible for
administering the program, the likelihood of corruption in implementation
should decrease. Given the immediacy with which the endowment effect
takes root, corporate agents could even implement the program in the least
developed nations by setting up tents and having people pick up their
distributions at one table and pay their taxes at the next. This should be no
more difficult than mass vaccination, a project that has been tremendously
successful in many developing nations. Finally, a concern for Sandbu’s
plan erased by involving corporations is the risk that governments will be
pressured to keep the tax so low that not enough money will be available
for public works even if governments want to spend it on the public. This
is not a concern with taxed corporate direct distribution because a large
percentage of resource rents are never distributed. If governments want to
spend on development, enough money will be available.

While these advantages and disadvantages are important, it is worth
restating that the main difference between NWAs and taxed corporate
direct distribution is that incentives are there to put one in place and not

53. Sandbu, supra note 5, at 1163.
54. Id. at 1165.
55. Id. at 1164.
56. Birdsall & Subramanian, supra note 5, at 87.
57. Id.
the other. Therefore, taxed corporate direct distribution is a feasible cure for the resource curse; NWAs are not. Sandbu’s proposal, however, is still a significant positive step away from transparency plans like EITI. Transparency is not enough to produce the accountability needed to end the resource curse. Something is needed to make people, even in undeveloped civil societies, care how governments spend their money. That something is taxation, and NWAs and taxed corporate direct distribution succeed where transparency initiatives fail by recognizing this fact.