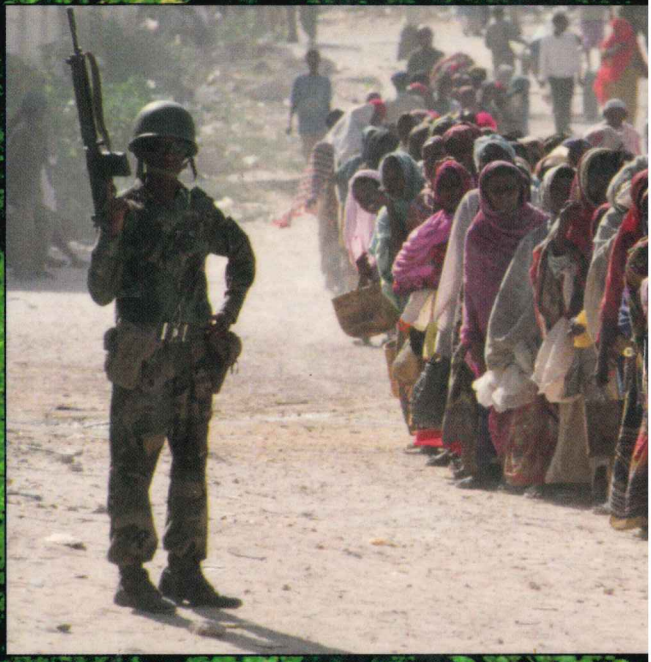
Natural Resources and Violent Conflict

Options and Actions



Ian Bannon and Paul Collier
EDITORS

THE WORLD BANK

GBIF	Global Biodiversity Information Facility
GDP	Gross domestic product
GeSI	Global e-Sustainability Initiative
HIPC	Highly Indebted Poor Countries
IFC	International Finance Corporation
IMF	International Monetary Fund
INTOSAI	International Organization of Supreme Audit Institutions
ITTO	International Tropical Timber Organization
LDC	Least developed country (United Nations grouping)
MIGA	Multilateral Investment Guarantee Agency
MMSD	Mining, Minerals, and Sustainable Development
MPLA	Popular Movement for the Liberation of Angola
MSC	Marine Stewardship Council
NEPAD	New Partnership for Africa's Development
NGO	Nongovernmental organization
NPFL	National Patriotic Front of Liberia
OECD	Organisation for Economic Co-operation and Development
PEFC	Pan European Forest Certification Council
RCD	Congolese Assembly for Democracy
ROSC	Reports on the Observance of Standards and Codes
RUF	Revolutionary United Front, Sierra Leone
SLORC	State Law and Order Restoration Council
SOFAR	State Oil Fund for the Azerbaijan Republic
SPLA	Sudan People's Liberation Army
TOTCO	T'Chad Oil Transportation Company
UN	United Nations
UNDP	United Nations Development Programme
UNEP	United Nations Environment Programme
UNITA	National Union for the Total Independence of Angola
WTO	World Trade Organization

CHAPTER 1

Natural Resources and Conflict: What We Can Do

Ian Bannon and Paul Collier

CIVIL WARS BESTOW MOST OF THE suffering on noncombatants, who tend to have little say in whether the conflict is initiated or if and when it is settled. As the conflict rages, incomes tend to plummet, mortality rises, and diseases spread. A generation's worth of education can be lost as education systems collapse for all but the privileged few. Civil wars are not temporary glitches in an otherwise smooth development path—the direct and indirect costs during the conflict are typically so high that even when post-conflict progress is dramatic and sustained, it will take countries a generation or more just to return to prewar conditions. This is because many of the costs of the war continue to accrue long after the fighting has stopped: the peace dividend proves elusive as the government finds it difficult to cut military spending; violent crime tends to explode, affecting people and the investment climate; capital flight continues and private investors, local and foreign, remain skittish; the prevalence of epidemics and disease remains higher than before the war; and human and social capital, destroyed or frayed during the war, can take decades to recover. Although there may be a few cases where a successful rebellion has ushered in social progress or led to the downfall of an oppressive and predatory regime, the majority of civil wars produce a spectacular failure of development. For the affected country, civil war represents development in reverse.

The costs of conflict, however, do not stop at the borders of the unlucky country. Civil wars also affect the country's neighbors and the global community. The costs suffered by other countries in the region may be as large as those suffered within the country, as the effects of the war spill across borders. The most obvious impact is through the

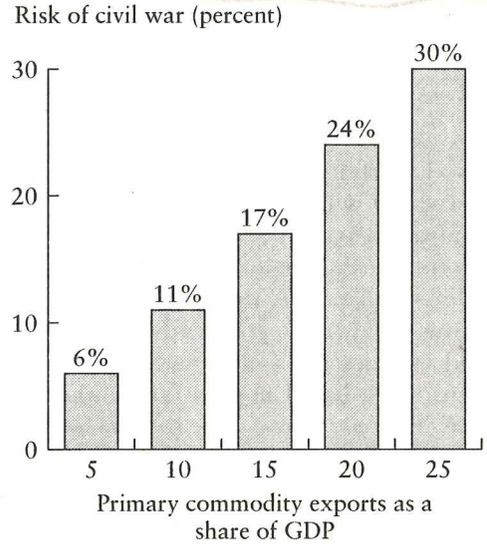
creation of large numbers of refugees, who impose a heavy economic burden on the host country and, because of their conditions on arrival and the crowded and unsanitary conditions in camps, exacerbate the risks of infectious diseases such as malaria, tuberculosis, and HIV/AIDS. A civil war in the neighborhood also leads countries to raise their defense spending, often generating a regional arms race. Conflict also disrupts regional trade and discourages foreign investors, who tend to regard the whole region as risky, even after the war has ended.

Civil war is also bad for the global community, especially in terms of three "global bads": drugs, AIDS, and terrorism. The cultivation of hard drugs requires territory outside the effective control of government. One consequence of conflict is that large rural areas tend to fall outside government control, making it difficult, if not impossible, to mount effective eradication measures. Conflict is an important vector of HIV/AIDS. Prevalence rates tend to be higher in conflict countries due to the more risky sexual behavior of combatants, coupled with their living conditions, mobility, age, and isolation from family and communities (Elbe 2002). The large and often massive movements of population induced by conflict favor the spread of AIDS, complicating the efforts of the international community to control the pandemic. By creating territory outside the control of a recognized government, conflict also provides terrorist organizations the safe haven they need to flourish and mount their attacks.

Understanding the Drivers of Conflict

Although, like Tolstoy's unhappy families, every conflict is unique in its own way, conflicts appear to embody recurring factors, which are often surprisingly strong. If reducing the risk of conflict is both necessary and possible, before we can propose measures to reduce the incidence of conflict we need to understand what makes countries vulnerable. Many models attempt to explore the factors that affect the risk of conflict (see, for example, Elbadawi and Sambanis 2002; Hegre and others 2001). In this chapter we review the results of the Collier-Hoeffler model and their findings on the links between natural resources and conflict (Collier and Hoeffler 2003). After testing for a number of factors, Collier and Hoeffler find that three are significant—the level of income per capita, rate of economic growth, and structure of the economy, namely, dependence on primary commodity exports. Doubling per capita income roughly halves the risk of a civil war. Each additional percentage point of growth reduces the risk by about 1 percentage point. The effect of primary commodity dependence is nonlinear, peaking with exports at around 30 percent of gross domestic product (GDP). A country that is

Figure 1.1 Natural Resources and Conflict Risk in Low-Income Countries



Source: Based on Collier and others (2003).

otherwise typical but has primary commodity exports around 25 percent of GDP has a 33 percent risk of conflict, but when such exports are only 10 percent of GDP, the risk drops to 11 percent (figure 1.1) Ethnic and religious composition also matters. Societies in which the largest ethnic group accounts for 45 to 90 percent of the population—which Collier and Hoeffler term "ethnic dominance"—have a risk of conflict about one-third higher. Other than in the case of ethnic dominance, ethnic and religious diversity actually reduces the risk of rebellion. Once a country has had a civil war, its risk of renewed conflict rises sharply, although this risk fades gradually over time at about 1 percentage point a year.

The tools of war need to be financed, making civil war an expensive proposition. Governments have established defense sectors and funding sources that support them, but to assemble, equip, and maintain a fighting force, the rebel group must find a regular source of income. Before the end of the cold war, rebel groups typically were financed by one of the superpowers or by proxy regional powers. With the end of the cold war, rebel groups have had to look for alternative funding sources. So irrespective of the motivation of the rebellion, the rebel group must also become a business organization. Its main and pressing challenge is to secure funds in order to wage war. If it cannot overcome this financing problem, the rebel group will wither away or be capable of only limited and low-level violence—more of

an irritant than a serious threat to an established government. Much of the economic analysis of rebellions tends to look for economic objectives, whereas much of the political literature generally ignores finance as a constraint. Yet finance is critical.

Natural Resources and Conflict: What Is the Link?

Unless a successful rebel organization is bankrolled by another country or an extensive and willing diaspora, it must generate income by operating some business activity alongside its military operations. The question then becomes the type of business activity in which a rebel group is likely to be competitive. Unfortunately, the obvious answer is that the rebel groups' only competitive advantage is their large capacity for organized violence and mayhem. Since, for military reasons, rebel groups tend to be based in rural areas, they turn to business activities such as various forms of extortion and the exploitation and trade of primary commodities.

Where rural areas produce primary commodities with high economic rents, generally for export, it is a relatively simple matter for rebel groups to run an extortion racket, levying protection charges on producers or carrying out some of the trade themselves. The best-known examples are the conflict diamonds of Angola and Sierra Leone. Alluvial diamonds are particularly well suited as a business line for rebels because the technology is so simple that the group can directly enter the extraction process and diamonds are a small, high-value commodity that is easy to hide and transport and has a readily accessible international market. As Michael Ross discusses in chapter 2, a number of other commodities such as coltan, drugs, gold, and timber have, at various times, been linked with civil wars in developing countries. In the case of high-value agricultural exports, the rebel group is not directly involved in production but levies informal taxes on producers and traders. The most spectacular example is that of illegal drugs, which, because of their illegality, are very high value. But even lower-value export crops are sometimes the target of rebel extortion—the Revolutionary United Front in Sierra Leone started by levying informal taxes on coffee and only shifted its activities to diamonds once it was well established.

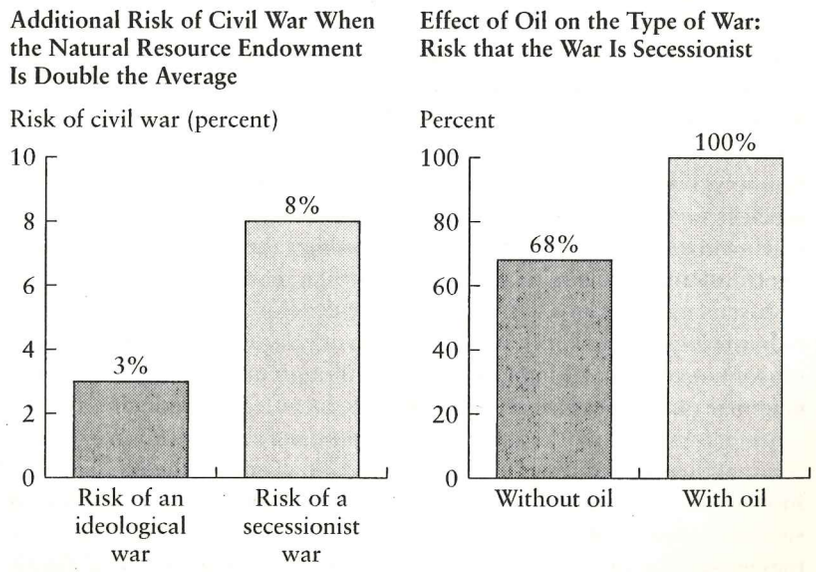
Some extractive industries require sophisticated technology, generally supplied by a multinational company. This, too, provides opportunities for extortion. Rebel groups can target foreign companies and threaten expensive infrastructure, such as an oil or natural gas pipeline. As pointed out in chapter 2, a particularly remarkable recent development is for rebel groups to raise finance by selling the advance

rights to the extraction of minerals that they do not control, but that they intend to control. This method of financing the tools of war through the sale of extraction rights is what Ross terms "booty futures."

Violent secessionist movements are statistically much more likely if the country has valuable natural resources, with oil being especially dangerous. Examples include Aceh (Indonesia), Biafra (Nigeria), Cabinda (Angola), Katanga (ex-Congo), and West Papua (Indonesia). There is some evidence that rebel leaders greatly exaggerate the likely gains from controlling the resources. This exaggeration is in part strategic, as secessionist leaders simply seize on the resource issue to build support for their movement. For example, leaders of the GAM (Gerakan Aceh Merdeka) rebellion in Aceh propagated the notion that secession would turn the province into another Brunei. Ross (2002) estimates that this was more than a tenfold exaggeration. But leaders themselves may also succumb to the glamour of the riches to be had from natural resources and overestimate the likely windfalls.

The discovery of a new natural resource or a higher endowment of a known resource greatly increases the risk of conflict in low-income countries, especially if the resource is oil (figure 1.2). In many such instances, ethnic cleavages can appear to cause the rebellion. In most societies, wherever a valuable resource is discovered, some particular

Figure 1.2 Risks from Natural Resources



Source: Based on Collier and others (2003).

ethnic group is living on top of it and has an incentive to assert its rights to secede. All ethnically differentiated societies have a few romantics who dream of creating an ethnically "pure" political entity, but the discovery of resources has the potential to transform such movements from the romantic fringe into an effective and violent secessionist movement. Although this type of secessionist movement appears ethnically based and cloaks its justification in the rhetoric of ethnic grievances, it would seem a mistake to consider ethnicity or religion as the driver of conflict.

Poor governance and corruption can also exacerbate secessionist tendencies, especially if the secessionist group has a fighting chance of wresting control of a valuable natural resource. Where a region sees what it considers its resources stolen by a corrupt national elite comfortably ensconced in the capital, the prospect of gaining control over the natural resource revenues and using them for the benefit of the local ethnic majority can be a powerful driver for a secessionist movement.

Kidnapping for ransom targeted at foreign extractive companies also can be a profitable business. In the 1990s kidnapping became the third largest source of financing for Colombia's two rebel groups (National Liberation Army and Revolutionary Armed Forces of Colombia), after drugs and extortion. Kidnapping netted the Colombian guerrillas an estimated $1.5 billion during 1991–99, and these revenues have been rising. In 1999 the two groups are estimated to have received a combined $560 million from extortion and kidnapping (Pax Christi Netherlands 2001, pp. 33–34). A large number of kidnap victims are employees of foreign extractive industries. Oil companies are especially frequent kidnap targets, and in some regions kidnapping has become a regular routine for them. Rebel groups may also target foreign tourists for kidnapping, as has happened in the Philippines. Following each successful kidnapping, rebel recruitment soars, presumably because young men anticipate large payoffs. In Colombia rebel groups have combined with urban-based criminals to create a market in kidnapped people. Criminals undertake the kidnapping, selling the victim to the rebel group, which then demands ransom.

Just as markets have emerged in some developing countries to trade kidnap victims, markets have emerged in developed countries to supply ransom insurance. Kidnap insurance, although understandable from a personal or business sense, has the perverse effect of reducing the incentive to protect workers from kidnapping, increasing the size of ransom payments, and lowering the transaction costs for the rebel group. In Colombia rebels are reputed to have, at times, gained access to insurance company data and thus been able to determine whether the actual or intended victim has kidnap insurance (Pax Christi Netherlands 2001, p. 30).

Wars also appear to have been lasting longer. The expected duration of conflict is now more than double that of conflicts that started prior to 1980 (Collier, Hoeffler, and Söderbom 2001). We do not know why this is the case, but one possible explanation is that it is now easier to sustain a conflict than it used to be. Even without support from a superpower or from a neighboring government, it is possible to find alternative sources of revenue with which to equip and sustain rebel movements.

Once conflict breaks out, it tends to make matters worse through its effect on the structure of the economy. Many natural resource exports are relatively unaffected by conflict because they have high rents or operate in enclave-type settings, with minimal backward or forward linkages with the rest of the economy. Contrast this with manufacturing or service activities such as tourism, which tend to have low margins and are easily disrupted by conflict. Moreover, economic policies and institutions, which are key to economic diversification, deteriorate markedly during the conflict and take a very long time to recover. As a result, countries are likely to find themselves even more dependent on natural resources than before the conflict started. This makes conflict much harder to resolve and, when resolved, raises the risk of a return to war.

A Call for Global Action

More than a billion people live in low-income countries that have been unable to put in place and sustain policies and institutions that would allow them to join the group of more developed middle-income nations. These countries have generally been mired in economic decline and dependent on primary commodities. This group faces a high risk of civil war, which, if it materializes, sets them on a path of reverse development. Close to 50 armed conflicts active in 2001 had a strong link to natural resource exploitation, in which either licit or illicit exploitation helped to trigger, intensify, or sustain a violent conflict. In other countries with low-intensity conflict or collapsed states, corrupt officials and their opponents, often involved with organized crime and terrorist networks, siphoned off revenues from natural resources. In addition to sustaining conflict and undermining governance, resource exploitation has contributed to famines, the spread of diseases, population displacement, and serious environmental damage. Abundant natural resources, which should be a blessing for a low-income country, in most cases make poor people poorer.

The adverse effects of natural resource endowments flow through a variety of channels, but most of these are amenable to policies and

concerted global action. Some of the actions needed to avoid civil wars must come from the governments of developing countries themselves—for example, by making greater efforts to adopt economic policies and institutions that can stimulate growth and reduce poverty, improve governance and transparency, and redress reasonable grievances. Some measures, however, require concerted global action.

Building a more peaceful world is not just a matter of encouraging tolerance and consensus. It should involve a practical agenda for economic development and the effective global governance of the markets that have come to facilitate rebellion and corrupt governance. In the remainder of this chapter, we consider measures that can be regarded as part of a global development agenda and measures that are more appropriately viewed as part of the global governance of natural resources and its link to conflict.

The Development Agenda

Successful development is the best protection against civil war. In particular, raising and sustaining economic growth, diversifying the economy, and assisting countries to cope more effectively with commodity price shocks can all help to reduce the risk of conflict in low-income countries.

Raising Economic Growth. Faster economic growth would reduce the risk of conflict by raising the level of income and, indirectly over time, assisting diversification. The key issue is how to raise growth. There is a broad consensus that three instruments—domestic policies, international aid, and access to global markets—are all effective in raising growth.[1] The precise way in which they operate is subject to debate, but there is no significant disagreement on the merits of market access. Some analysts argue that aid and policies complement each other, with aid becoming more effective as policies get better and, conversely, policy reform being more effective as inflows of aid become larger. Other analysts argue that the beneficial effects of aid and policy are independent. The common ground is that, where policies are reasonable, aid is effective and that, where policies are not reasonable, policy improvement will enhance growth. The intention is not to enter into these arguments here but merely to assert that the old dictum of "good policies supported by generous aid and access to markets" remains an effective longer-term strategy for preventing conflicts.

Diversifying out of Trouble. One obvious way to reduce countries' dependence on natural resources is to help them to diversify their economies. Countries with a more diverse base of exports are better

protected from the adverse effects of price fluctuations and less prone to the resource curse. On average, developing-country exports are no longer predominantly primary commodities. But this average masks a skewed pattern—at one extreme, the successful developers that have achieved astonishingly rapid diversification and, at the other, a group of low-income countries that have been left behind by development and marginalized from world markets. The fact that the former group has succeeded shows that it is possible for the marginalized to do the same; however, diversification may not always be a realistic or even a desirable option—Botswana is a landlocked desert with few options other than diamonds. For such countries, the priority should be to make natural resource endowments work effectively for development, as Botswana has managed to do. But for many countries, diversification is surely a viable option.

Three factors significantly reduce a country's dependence on primary commodities: growth, aid, and policy. On average, growth diversifies an economy, which reduces the risk of conflict in addition to the direct contribution of growth to risk reduction. This does not imply that all policies that promote growth promote diversification, but there is some presumption that the inducement of growth will normally assist diversification. Aid significantly reduces primary commodity dependence. This may be partly a result of "Dutch disease," which, by increasing the availability of foreign exchange, leads to appreciation of the exchange rate and thus reduces export incentives. Aid may also improve infrastructure—transport, power, telecommunications—which can help to lower business costs and improve the international competitiveness of activities that do not rely on high location-specific rents for their profitability. Good economic policy also significantly promotes diversification. Collier and Hoeffler (2003) measure this using the World Bank's Country Policy and Institutional Assessment (CPIA) ratings. On average, an improvement of 1 point in the CPIA—roughly equivalent to the difference between African and South Asian policies—would reduce primary commodity dependence from 15.2 percent of GDP to 13.8 percent.

As pointed out in chapter 2, OECD (Organisation for Economic Co-operation and Development) countries can also help natural resource–dependent, low-income countries to diversify by removing tariff and nontariff barriers on value added goods. OECD countries place no tariffs on imports of unprocessed oil and minerals, but exporters quickly run into tariffs and nontariff barriers if they wish to add value to these raw materials.

Reducing Exposure to Price Shocks. Many of the problems caused by resource dependence come from the volatility of international prices.

Primary commodity prices are highly volatile so that countries that are heavily dependent on primary commodities periodically suffer from crashes in export prices. Studies show that commodity price shocks tend to promote corruption, weaken state institutions, and create a host of budget and management problems (see chapter 2). This is, in part, because shocks produce a multiplier contraction in output and severe fiscal pressures that do not disappear when prices recover. Recent research finds that when these shocks are large, they severely damage medium-run growth—each dollar of export income lost generates a further two dollars of output contraction (Collier and Dehn 2001). There is also some evidence that much of this lost growth is never recovered. Hence, negative price shocks may induce episodes of rapid and persistent economic decline that increase the risk of conflict.

Governments of low-income, shock-prone countries face macroeconomic management problems on a scale that developed countries have not seen since the 1930s. Yet their plight has received scant attention from donors. Shocks caused by natural disasters—earthquakes, hurricanes, floods, droughts—typically produce a massive and generous donor response, often overcompensating for the shock itself. Price shocks, such as the one being experienced by coffee producers today, although often much more devastating, have historically triggered no significant donor response. Until recently, the international community had two instruments to address the problem: the Compensatory Financing Facility (CFF) of the International Monetary Fund (IMF) and the Stabex Facility of the European Union (EU). For different reasons, neither of these worked well, and they are both dormant. The CFF was a nonconcessional borrowing facility, yet it is usually unwise for a country to borrow commercially at the onset of a severe negative shock. Stabex disbursements were so slow that they tended to be procyclical, arriving during the following price upturn.

Even the governments of developed countries, with sophisticated teams of experts, would find the management of such large shocks extremely difficult. Developing-country governments usually lack the expertise and political leeway to implement contractionary policies effectively. There is therefore a case for global action to cushion such shocks and assist countries to improve their risk management or transfer some of this risk. International financial institutions, especially the IMF and World Bank, could consider redesigning existing tools or developing new mechanisms to reduce the impact of price shocks. Beyond cushioning price shocks, there is also reason to reduce them where possible. Attempts to control commodity prices have failed repeatedly, and there seems to be little reason to propose them once again. However, the trade policies of countries in the OECD (Organisation for Economic Co-operation and Development) can exacerbate volatility for other countries. When OECD governments increase their subsidy to domestic producers in order to cushion them from a fall in the world price of an agricultural commodity, the effect is to amplify price shocks for the rest of the world. The cushioning that such subsidies provide to domestic OECD producers comes at the cost of increasing the price volatility for producers in low-income countries—precisely those that can ill-afford negative shocks and have few ways of softening the fall in prices.

The Governance of Natural Resources

Many low-income countries depend on primary commodities for their export and fiscal revenues. On average, such dependence is associated with increased risk of conflict, weak governance, and poor economic performance. However, the average conceals extremely wide variation. In 1970 Botswana and Sierra Leone were both low-income countries with substantial diamond resources. Over the next 30 years diamonds were central to the economic and social collapse of Sierra Leone—its per capita income is now much lower than it was in 1970, and the country has sunk to the bottom of the Human Development Index. By contrast, diamond resources were critical to Botswana's success in becoming the fastest-growing economy in the world and a middle-income country. Hence, although on average primary commodities have been a bane on development, they can also drive successful development. The natural resource curse is not destiny. The challenge, at both the national and international levels, is to adopt policies that better harness this potential.

The vast majority of resources that sustain and fuel civil wars depend on access to the global economy—to its markets, its financial intermediaries, its brokers, its investors, and the foreign companies that often extract a developing country's riches. This is not to decry the impact of globalization and add to the litany of negative effects ascribed to it. On the contrary, while globalization provides rebels with new opportunities, it also makes them more vulnerable to international pressure—more than would have been possible when rebellions were proxy wars of the superpowers—provided the international community is willing to exert it. The remainder of this chapter sketches out broad areas where global action would be effective, while the other chapters in this book explore each area in greater depth.

Who Gets the Money? Increasing Transparency of Natural Resource Revenues. Although these proposals for global action are directed primarily at the international community, governments of low-income, resource-rich countries should also have a strong interest. They are often under threat from rebel groups financed by natural resource revenues and would obviously benefit if these funding sources were choked off. But these governments need to show that their natural resource revenues are well used. As discussed, rebel movements, particularly those seeking to secede on the back of natural resources, are greatly bolstered by the presence of a corrupt elite that siphons off the revenues rather than a government that uses them transparently to raise living standards across the board. The government's best defense is likely to be credible scrutiny of the revenues that it receives, how they enter the budget, and how they are spent. There are two serious obstacles, however, even when governments aim to be accountable. First are the sheer magnitude of resource revenues and the scale of the rents relative to the size of the country's economy. Governments in low-income countries, with poor institutional capacity and little tradition of accountability and public scrutiny, face enormous problems in absorbing and effectively tracking large revenue flows. This is not to exempt or excuse corruption in resource-abundant countries but merely to indicate the scale of the pressures and hence temptations involved. Second, in many instances it is not enough for resources to be accounted for and relatively well used—the government is not fully trusted and so will need to convince doubters by establishing a credible independent process of verification. These two factors suggest that even countries wanting to do the right thing need help, which, if successful, may exert pressure on those governments that do not manage their resource wealth effectively.

One possible way to address these issues in an integrated way is to develop an international template for the acceptable governance of natural resource revenues to which a resource-rich government could choose to subscribe. Such a template would have five elements. First, the host government would require international companies in the extractive industries to report payments so as to allow appropriate scrutiny and international comparability. Such reporting could either be to the general public, as envisaged in the Publish What You Pay campaign discussed by Philip Swanson, Mai Oldgard, and Leiv Lunde in chapter 3, or to an independent entity such as the international financial institutions. Second, the government itself would require national resource extraction companies, whether private or government owned, to report on the same basis. Third, the government would undertake to report its receipts from all of the above sources and ensure that they

are easily tracked as they pass through the budget. Fourth, an independent entity, such as the international financial institutions, would collate the reported information, attempt to reconcile payments and receipts, integrate the figure for net government revenues with standard budget information on revenues and expenditures, and publish the results on an annual basis. A natural division of labor would be for the World Bank to collate, reconcile, and aggregate the data from companies and for the International Monetary Fund to integrate the net revenues into the budget data it already scrutinizes under its arrangements or Article IV consultations. Fifth, the government would designate and, if necessary, establish credible domestic institutions of scrutiny—such as parliamentary committees or ad hoc entities, including civil society organizations, as in Chad—to which the international financial institutions could report the information in a form that would be readily intelligible.

Where Does It Come from and Who Buys It? Shutting Rebel Organizations out of Markets. The Kimberley Certification Process Scheme is designed to make it increasingly difficult for rebel organizations to sell rough diamonds in global markets. The process, which took only two years to establish (a comparatively short time for a global initiative), is an important first step. As Corene Crossin, Gavin Hayman, and Simon Taylor discuss in chapter 4 and appendix 4.1, significant technical and operational issues remain to be addressed, and it is too early to judge whether the Kimberley process will be successful and sustained. However, it is an encouraging sign that this type of global action is indeed possible.

If the Kimberley process proves ineffective, the present private voluntary agreement will need to be reinforced by intergovernmental legislation and probably provide for enforceable sanctions. However, the existence of the private agreement shows that all parties have recognized the need for effective action and deserve the opportunity to demonstrate success. Moreover, if the Kimberley process is successful, it could form the model for the governance of other commodities for which there is significant inadvertent funding of conflict.

Realistically, the effect of better regulation of commodity markets is not to shut rebel organizations out of markets altogether. Efforts such as the Kimberley process for rough diamonds, chain-of-custody tracking arrangements for illegal logging, and other schemes discussed in chapter 4 can be effective even if rebels are still able to sell the commodities they extort from local producers, as long as they can sell these illegal commodities only at a deep price discount. In this respect, a key global action is to monitor and evaluate the Kimberley process,

while developing and implementing certification and tracking schemes for other commodities.

Going after the Money: The Finance of Illicit Commodities. A practice that financed several rebel organizations in the 1990s is the sale of booty futures, whereby a rebel organization receives finance in advance in return for an entitlement to natural resource extraction in the future should the rebellion succeed. Reputable companies rightly view this practice as unacceptable; nevertheless, it happens on the fringes of the corporate world. As Philippe Le Billon discusses in chapter 6, there is a strong case for making such transactions criminal in the company's home country, analogous to the OECD agreement to criminalize international bribery.

Extortion and kidnapping have also become an important source of financing for rebel movements, and, as discussed earlier, the financial flows involved can be considerable. Although companies should be discouraged from operating in such conditions, the insurance industry has developed products offering ransom insurance. The overall effect of this is evidently to increase ransom payments, and there is a good case for banning ransom insurance. OECD governments could also undertake and live up to a commitment that public money will not be used to pay ransom to rebel movements and, correspondingly, that extortion payments will not be treated as tax-deductible business expenses. There is also a strong case for OECD countries to consider antidrug policies that reduce financial flows to rebel groups.

Tightening Scrutiny on Illicit Payments. The proposed template is intended to ensure that legitimate payments from companies to governments are properly accounted for and used. Illicit payments by natural resource extraction companies to bribe people of influence are a different problem. The OECD agreement to criminalize such payments is a start, but bribes to officials can be disguised as "facilitation payments" to companies controlled by their relatives, and so complementary efforts are required. Some resource extraction companies, in line with OECD Guidelines for Multinational Enterprises, have now undertaken not to make facilitation payments. It would be desirable to make greater efforts to encourage adoption by non-OECD countries (chapter 6) but also to encourage the industry to determine precisely what is the boundary between legitimate and illegitimate payments and to embed this in corporate rules of behavior.

There is also an important role for the international banking system. The family of President Abacha was able to deposit in reputable international banks sums vastly in excess of his presidential salary, evidently illegally siphoned off from Nigerian oil revenues. Banks now have somewhat greater responsibility to know their clients and to report suspect receipts. There is also increasingly greater cooperation in securing the repatriation of corrupt money. However, there is scope for much tighter reinforcement of antibribery legislation on the part of the international banking system. As Jonathan Winer and Trifin Roule propose in chapter 5, the Financial Action Task Force should consider extending its recommendations to the exploitation of drugs or any other form of trade in illicit natural resources.

In some cases, even the best scrutiny and information on the dealings of corrupt officials and politicians will have no effect. Leaders and politicians may be impervious to moral pressure or wield sufficient power to place them above their own national law. In such cases the international community has some responsibility to impose penalties that target the guilty party and his or her associates without inflicting suffering on the society. The United Nations has been developing smart sanctions that offer some scope for such a targeted approach to penalties. These types of sanctions should be strengthened and internationally supported.

Attracting Reputable Companies to Risky Environments. At present, some low-income countries face severe difficulties in attracting reputable resource extraction companies to exploit their resources. When reputable resource extraction companies withdraw from difficult environments as a result of greater international public scrutiny, they may well be replaced by companies that are less reputable or less vulnerable to international pressure or shareholder concerns. In this case, global efforts would be counterproductive. As John Bray discusses in chapter 7, survey evidence suggests that the two main impediments deterring good companies from entering very risky environments are the risk to their reputations and the political risk of unreasonable treatment. The template described in this chapter has the potential to address both of these risks.

One advantage of the Chad-Cameroon pipeline model of improved governance of natural resource revenues is that it provides international companies with a degree of reputational protection. The international financial institutions in effect certify a governance structure as acceptable. The introduction of a more standardized template for appropriate governance, and its adoption by governments interested in attracting reputable companies, would provide a much higher degree of reputational cover. Such a template also has the potential to address political risk. At present, the insurance entities that supply cover for political risks, such as the World Bank Group's Multilateral Investment Guarantee Agency (MIGA), have to assess each governance situation entirely on an ad hoc basis. Where governments subscribe to the good governance template, this would be pertinent information for MIGA and other insurers and could considerably facilitate their willingness to provide cover.

Note

1. An additional issue, not discussed here, is whether the way of raising growth inadvertently increases the risk of conflict. Collier and Hoeffler (2003) find that policies that raise growth rates do not directly increase the risk of conflict.

References

The word "processed" describes informally produced works that may not be commonly available through libraries.

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CHAPTER 2

The Natural Resource Curse: How Wealth Can Make You Poor

Michael Ross

SINCE THE MID-1990S THERE HAS BEEN a growing body of research on the causes of civil wars. One of the most surprising and important findings is that natural resources play a key role in triggering, prolonging, and financing these conflicts. This report summarizes the main findings of recent scholarship on the role of natural resources in civil wars and discusses some policy options.

The natural resources that cause these problems are largely oil and hard-rock minerals, including coltan, diamonds, gold, and other gemstones. Sometimes other types of resources are also at fault—notably timber. And if drugs are considered a natural resource, they too have played an important role in several conflicts. Table 2.1 lists 17 recent conflicts that are linked to natural resources. In eight of these, gemstones are one of the resources; in six, the resource is oil or natural gas; in five, it is some type of illicit drug; and in three cases, it is timber. In most of the conflicts, multiple resources play a role.

Resource-related conflicts may pose special problems for the states of Africa. Of the 17 resource-related conflicts in table 2.1, nine are in Africa. Moreover, conflicts in Africa, of all the world's regions, show the most worrisome trends. Between 1992 and 2001 the number of armed conflicts outside of Africa dropped by half, yet the number of conflicts in Africa stayed roughly the same (table 2.2). Moreover, within Africa, armed conflicts have grown more severe. During the 1970s and 1980s, half of all intrastate conflicts in Africa could be classified as civil wars—that is, they generated at least 1,000 battle-related deaths each year. In the 1990s two-thirds of Africa's intrastate conflicts were civil