

# 1. The case for “Local Oil Nationalism”

## 1.1 Secession-prone regions

Violent secessionist movements are statistically much more likely to be formed 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. Quoting Ross (2007), “if the mineral producing country is onshore and concentrated in one or several parts of the country, a booming mineral sector may affect the geographical distribution of income. [...] There is partial support for the proposition that resource wealth facilitates civil wars by funding rebels. Civil wars are correlated with fuel onshore but not Fuel offshore; offshore oil and gas deposits afford rebel groups fewer extortion opportunities. Secondary diamonds, which measures the most lootable resource—and hence is the most likely to contribute to rebel finance—is uncorrelated with civil war onsets in eight of the nine models. This remains the most controversial causal mechanism, and it has been challenged by several studies<sup>13</sup>”.

The more unevenly concentrated the resources are, the higher the risk of secession. Resource wealth may increase the expected value of a military coup in mineral-rich regions, and may motivate separatist movements by increasing the expected benefits – or reducing the apparent costs – of sovereignty in resource-rich regions. The region may feel the need to “protect” the resources coming from its soil, seeking secession. The rest of the country may sustain claims about the control of the resources. Predatory groups may gather up to take control of the area. Rebel groups may want to get access to the oil sources to control the rest of the society, which relies on this resource for transportation and heating.

Nevertheless, the total reserves of a region are not the only element defining the likelihood of civil conflict. The important information is not how much oil is effectively extracted, but what the expectations are (“boot rights”). Chad

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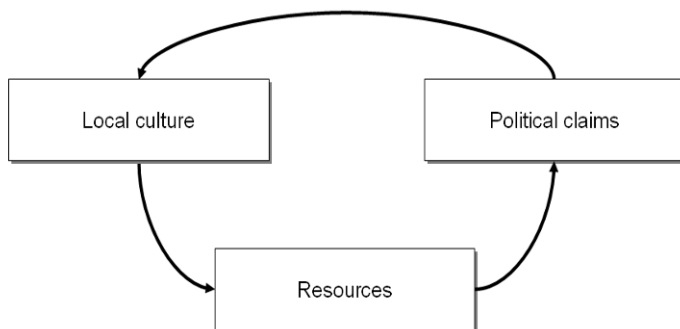
<sup>13</sup> Ross, Michael (2007), *How Mineral-Rich states Can Reduce Inequality*, Columbia University Press, p. 244

experienced oil-related violent conflict even though not a single drop of oil had been extracted. Heal (2007) mentions the example of Saudi Arabia, where at 60 USD per barrel, the oil wealth per capita is around 630,000 USD. Invested at 4%, this would represent 25,000 USD per person per year: a high possible income indeed. The country normally extracts enough oil for an actual income of 7,000 USD per capita a year. Furthermore, “this income, if used for consumption, is not sustainable, since it depends on the depletion of a finite stock”. It seems therefore, that the element of expected oil reserves in motivating secession attempts has to be “mediated” by additional considerations that go beyond the mere quantitative calculation of resources at disposal of citizens.

There might be a misconception about the wealth which citizens may be able to enjoy, because of an outright overestimation of the present reserves. This mistaken belief might be cultural or endemic, or may be developed through a motivated plan of a rebellion group that believes it can leverage popular support and, in the end, become the only holder and benefited user of the resources.

Therefore, in order to define a “risky” situation, a concurrence of more factors is needed. A resource-related secession is attempted if there is connection between local culture, resources and political claims.

*Figure 1– Resource-related secession factors*



Within extractive regions, political parties with a secessionist agenda may attempt to attract votes by appealing to a common sense of identity. The key point is that this sense of common identity must be “imagined” since it does not

reflect real social interaction<sup>14</sup>. The only element linking together population and identity may be represented by the mere element of resource presence.

In general, “Secessionist movements present themselves to the global public as analogues of colonial liberation movements: long-established identities are denied rights of self-determination by quasi-imperial authorities. Self-determination is presented as the solution to the challenge of peaceful coexistence between distinct peoples<sup>15</sup>”. The economic effect of oil revenue is seldom the only cause for the build-up of rebellion. As stated by various researches (Ross 2000, Collier & Hoeffler 2002), in most cases oil acts as a concurrent cause. It is therefore useful to establish whether the tendency to secession traces back its cause to a pre-existing cultural element.

An important element in this correlation is the one linking location and kind of resources, to the type of conflict that could possibly break out. It is very important to clarify that to measure “proximity” we mean the distance of the center of administrative coordination (a capital city) to the center of control of the resources. Therefore:

- On-shore resources close to the capital are considered “proximate”
- On-shore resources on the border are considered “distant”
- Off-shore resources are considered “proximate” in all cases, because their center of control is in the capital, not on the platforms

*Table 1 – Relation between the characteristics of resources and types of conflict.*  
Source: LeBillon (2005), p. 16

Characteristics	Point	Diffuse
<b>Proximate</b>	Coup d'état	Peasant/ Mass rebellion
<b>Distant</b>	Secession	Warlordism

It is not only the distribution of resources that is important, but also the proximity to the center of power. On-shore resources closer to capital cities are less likely to be captured by rebel forces. The Figure, as described by Le Billon (2005), is not a systematic correlation. In the case of oil, as a “Point” resource, it

<sup>14</sup> See Anderson, Benedict R. O'G. (1983), *Imagined Communities: Reflections on the Origin and Spread of Nationalism*, Verso

<sup>15</sup> Collier, Paul & Hoeffler, Anke (2002), *Aid, Policy and Peace: Reducing the Risks of Civil Conflict*, University of Oxford, p. 37

generally leads to problems of secession or Coup d'état. In the scope of this project, therefore, the main focus is on the secession problems, because we are dealing with those cases where a specific region is more resource-rich than the rest of the country.

Point resources distant from the center of power, for geographical or political reasons, are more likely to be associated with armed secession. Rebel movements may find it strategically more feasible to secede, than trying to gain control of the central structure of the state. Furthermore, while diffuse resources can generally be exploited without a “political” acknowledgment of the secession, point resources need an official political representation, as the subject entitled to invite investors and infrastructure builders to exploit them.

As briefly mentioned, the presence of oil operators in the extractive region, is a defining element in the creation of a socially sustainable environment. Extractive companies of any kind may be useful to introduce the necessary frameset of contracts and property law, accounting and financial standards, or even for technology and infrastructure, into the producing country. Moreover, they may help create a “business attitude” within local citizens, which may facilitate the solution of disputes through peaceful means, rather than armed conflict.

Oil companies can be clustered basing on the operations they deploy and on their relationship to the state. “International Oil Companies” (IOCs): are the emanation of oil and gas consuming economies, and their goal is to satisfy their industrial goals by producing and selling resources. “National Oil Companies” (NOCs): are the emanation of oil and gas producing economies, and their goal is to implement the appropriate resource-exploitation strategies in order to maximize returns for their national economies.

Considering their relationship with the state, oil companies can be further ordered into specific groups, as in the following table:

*Table 2 – Clustering National and International Oil Companies*

	<b>Oil rights granting / auctioning</b>	<b>Full operations</b>
<b>National</b>	NNOC, NIOC, SNPC, ...	Saudi Aramco, Pertamina, ...
<b>International</b>	Not applicable	Oil majors

In terms of impact on the population, and specifically on the regional population, the configuration of the NOC is very important. For better or for worse, the NOC is the personification of the central government, and its acceptance depends on the political conduct of the state, as well as on the local management. In analyzing this complicated relationship, many things must be taken into account, such as: the representation of local personalities in the management of the company; the relationship with the military in controlling the territory; and, the historical relationship with the company.

Local impact may also be measured in terms of number of people employed on annual production. Such ratios cannot be compared to that of IOCs, due to their completely different structures.

*Table 3 – Total employees per ‘million barrel equivalent (Mboe)’ produced per year. Source: company statements*

<b>Operating NOCs</b>	<b>Employees / Mboe</b>	<b>Non-operating NOCs</b>	<b>Employees / Mboe</b>
<i><b>Saudi Aramco</b></i>	11	PDVSA	16
<i><b>Petronas</b></i>	38	NNPC	20
<i><b>Statoil</b></i>	39		
<i><b>NIOC</b></i>	43		

Concerning the interrelation between International Oil Companies (IOCs) and an oil producing country, we may broadly distinguish our analysis into two levels: the impact on the state institutions, and the impact on local communities.

In terms of impact on the central state, we could group the general tendencies in different clusters, which we may define as “integrated collaboration” and “service cooperation”. The first concept refers to companies which closely interact with all the levels of central government, offering forms of collaboration that may extend to the building of infrastructures in the producing countries. This

form of cooperation is mostly present if the investing IOC has some form of state participation in its capital.

In the case of “service cooperation”, oil companies try to interact with the producing state government as little as possible. This approach can be used by either: companies that are too small in scope and dimensions to leverage any other strategy; or by companies which simply prefer not to involve national governments on the agreements, even for limits prescribed by their public capital structures.

In terms of impact on local communities, the extremes are represented by “isolation” and “development support”. It is important to notice how the choice might be a deliberate decision of the IOC, or it may be imposed by the central government. In the case of “isolation”, the IOC tries to act as a “separated entity” from the rest of the community, and interacts with it only through the central government. The IOC only engages in direct actions if it feels that security (both imminent and long-term) is affected. The physical realization of this approach is represented by elements such as the building of sophisticated defense infrastructures.

With “development support” the IOC is involved in developmental and integration projects that concern the local community. Such projects may be formative, job-market related, infrastructures (building of hospitals and schools), or may include some forms of direct profit redistribution, depending on the agreements.

*Table 4 – Interrelationship between interaction models of IOCs with the central government and the local communities*

	<b>Integrated collaboration</b>	<b>Service cooperation</b>
<b>Development support</b>	Case A	Case C
<b>Isolation</b>	Case B	Case D

Case “A” is a model of integrated collaboration and development support. It may offer advantages in terms of planning the interaction of the IOC with the political and social patterns of the company, but, as all integrated collaboration approaches, may be risky on the side of the ethical/moral risks towards the central government.

In case “B”, an IOC that cooperates with the central government, but isolates itself from the local community, runs the risk of being seen as an “occupation agent” on behalf of the government. The local population may read IOC as a

subject that pays off the central government to carry on the operations it needs for the profits. The only antidote for this problem is to make sure that the central government, on its own, undertakes policies that foster local development.

Case “C” significantly limits the effort that a company can spend in fostering development with the local community. Normally, this is due to the fact that the company prefers to limit its “corporate contact” only to the industrial side, rather than the political side. Nevertheless, some programs may be implemented in order to allow the training of managers hired from local people, or to provide scholarships to let local employees study abroad.

Case “D” has lost most of its popularity in the last years, due to the corporate disasters that companies like Exxon and Shell experienced respectively in Indonesia’s Aceh and in the Niger Delta. Of all cases, the “D” case is probably the one most affected by short-sightedness. Although it may prove effective in coping with situations already characterized by civil conflict, in general and in the medium term, it does not prove convenient, even from a strictly industrial perspective.

The stability of state institutions is fundamental to prevent the insurgence of economic problems and social instability related to hydrocarbons wealth: Long-term vision and wise spending strategy can be fostered only by stable political systems. Nonetheless, in absolute terms there is no better or worse form of state for ruling a developing oil-endowed country. It depends on many different features, varying from culture, to ethnicity, to traditions<sup>16</sup>. A certain oil revenue distribution policy may work within a particular institutional structure, and may not in others. A “stable dictatorship”, as in the Suharto regime in Indonesia, may function better than an “unstable democracy”, like the one that failed in Nigeria in 1980.

Oil is a great “challenger” to the order of a state. States are based upon a “social contract”, which shapes economy and relationship between social classes; and such a “contract” is influenced by mineral revenue. As observed by Ross (2001) based on a previous research by Luciani (1987), when governments derive sufficient revenue from the sale of oil, they are likely to tax their populations less heavily or not at all, and citizens in turn would become less

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<sup>16</sup> This consideration does not apply to advanced industrialized states. As evidenced by Ross (2001), p. 343: “large oil discoveries appear to have no discernible antidemocratic effects in advanced industrialized states, such as Norway, Britain, and the U.S., but may harm or destabilize democracy in poorer countries”. Democratic economies seem to be more resilient to oil rents if the democratic form was introduced before the discovery of hydrocarbons, because the experience of public wealth management in other sectors could represent an advantage (see Listhaug, 2005)

interested in monitoring the activity of the state. Thus, the state may become less accountable.

Such consideration derives from various observations on the effect that resource wealth exerts on industrialized states “large oil discoveries appear to have no discernible antidemocratic effects in advanced industrialized states, such as Norway and Britain, and the U.S., but may harm or destabilize democracy in poorer countries<sup>17</sup>”.

This effect may also be present at a regional level. When comparing the Indonesian developed province of East Kalimantan, with the historically conflict-ridden province of Aceh, we may observe that in the first case the large expansion of logging, together with a gradual insertion of the oil industry (the beginnings trace back to the early XX Century), was very positive to foster economic success. In East Kalimantan, locals were involved in production, and companies engaged the state in building up the infrastructures they needed in order to carry on operations.

The question of developing an efficient, accepted, and fair regulatory system for mining is not separated from the necessity of having developed stable state institutions before the oil boom. In the general case, within the first twenty “oil rich states”, only Norway has a stable and mature democracy, and was in this condition before the resource boom. Some scholars have suggested that oil seems to hinder the development of democracy (see Ross 2007, Collier vv. And Lynn Karl 1997). Nevertheless, nothing guarantees that the states in the list would have developed a democracy “in absence” of exploitable resources.

Oil rents create dependence, form new social clusters, influence economic relationships, heat up the competition for power, and foster the influence of organized interests alternative to the state. In particular, a specific distribution policy has direct effect in shaping the middle class and the specialized labor force (see Ikelegbe, 2001). Any decision to set up alternative fiscal bases often may collide with the interests of such groups.

To face these issues, the political system needs to rely on organized interests, specifically those of particular social classes, or specific groups. Reducing political guidance and widening commitment to market forces will not necessarily deliver the expected benefits of better rents allocation and economic development. Shrinking the state jurisdiction would in most cases substantially increase prices, and the market would focus mostly on short-term gains, with few concerns for social planning. In the worst case scenario, uncontrollable oil

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<sup>17</sup> Ross, Michael (2001), *Does Oil Hinder Democracy?*, Muse project, pp. 343-344



oligopolies would form. Their eradication is seldom possible without some form of social tension.

In assessing the aspect of state form, we can refer to a distinction proposed by Eifert & Gelb (2002). The typical forms of state, for oil-exporting countries, are clustered into five categories: mature democracies, factional democracies, paternalistic autocracies, predatory autocracies, or reformist autocracies. Each form has a different impact on how the revenue is managed, and how a society is shaped by such economic rents. Such rational structure can be completed by the “Polity IV Index<sup>18</sup>”.

*Table 5 – Forms of government with relative institutional and economic implications*

Political features	Institutional implications	Economic implications
<b>Mature democracy</b>		
Stable party system	Long policy horizon	Saving likely
Range of social consensus	Policy stability, transparency	Expenditure smoothing, stabilization;
Strong, competent, insulated bureaucracy	High competitiveness, low transaction costs	Rents transferred to public through
Competent, professional judicial system	Strong private/traded sector, pro-stabilization	government-provided social services
Highly educated electorate	interests vis-à-vis pro-spending interests	and insurance or direct transfers
<b>Factional democracy</b>		
Government and parties often unstable relative to interest groups	Short policy horizon	Saving very difficult
Political support gained through clienteles and provision of patronage	Policy instability, non-transparency, high transaction costs. Strong state role in production	Pro-cyclical expenditure; instability
Wide social disparities, lack of consensus	Strong interests attached directly to state expenditures; politically weak private non-oil	Rents transferred to different interests and to public through subsidies,
Politicized bureaucracy and judicial system	sector and pro-stabilization interests	policy distortions, public employment
<b>Paternalistic autocracy</b>		
Stable government; legitimacy originally from traditional role, maintained through rent	Long horizon	Pro-cyclical expenditure, mixed
distribution. Strong cultural elements of consensus, clientelistic, and nationalistic	Policy stability, non-transparency	success with stabilization
	Low competitiveness, high transaction costs	Risk of unsustainable long-term
	Strong state role in production	spending trajectory leading to

<sup>18</sup> The "Polity Score" captures this regime authority spectrum on a 21-point scale ranging from -10 (hereditary monarchy) to +10 (consolidated democracy). The Polity scores can also be converted to regime categories: we recommend a three-part categorization of "autocracies" (-10 to -6), "anocracies" (-5 to +5 and the three special values: -66, -77, and -88), and "democracies" (+6 to +10); see "Global Regimes by Type, 1946-2006" above”.

patterns. Bureaucracy provides both services and public employment	Strong interests attached directly to state expenditures. Weak private sector	political crisis Little economic diversification
<b>Reformist autocracy</b>		
Stable government, legitimized by development. Social range of consensus toward development. Constituency in non-oil traded sectors. Insulated technocracy	Long horizon. Policy stability, non-transparency Drive for competitiveness, low transaction costs Strong constituency for stabilization and fiscal restraint	Expenditure smoothing, stabilization State investment complementary to competitive private sector ;Active exchange rate management to limit Dutch disease
<b>Predatory autocracy</b>		
Unstable government, legitimized by military force. Lack of consensus-building mechanisms Bureaucracy exists as mechanism of rent capture and distribution; corrupt judicial system. Little or no civic counterweight	Short horizon. Policy instability, non-transparency. Low competitiveness, high transaction costs. Spending interests strong vis-à-vis private sector or pro-stabilization interests	No saving. Highly pro-cyclical expenditure. Very high government consumption, rent absorption by elites through petty corruption and patronage, capital flight

An important, additional aspect in the evaluation of the stability of an oil-rich country, concerns the role of the military and its relation with the state: “A country that is weak in providing resources for its military will face difficulties in managing its soldiers – whether in political or in business roles in which they have been performing for far too long. Should the condition continue, one day the over powerful military will perceive themselves as the state itself<sup>19</sup>”. The conditions may worsen so much, that the military may become a challenger to the state in exerting resource-related revenue; even becoming the main force pushing for secession. The military may become the main controller and administrator of local resources, with or without support by the local population. In particular cases, disbanded soldiers may team up and form irregular armies, seizing resources in the region, or may enter other regions (even foreign ones) gaining access to resource-related funds. Armies may become particularly dangerous because they generally rely on advanced levels of organization and training, and may have access to funds and arms dealers. It is not by chance, that some of the most persistent resource-related uprisings show some relationship to groups of former/disbanded soldiers.

The specific relationship which ties a state to its military force may signal whether, in case of difficulty, soldiers will remain loyal to the government, or

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<sup>19</sup> VV.AA. (2005), Practices of Military Business – Experiences from Indonesia, Burma, Philippines and South Korea, Friedrich Ebert Stiftung, p. 4

will try to pursue autonomous goals of enrichment. Such relationships may be of different kinds. The military may be controlled by the state to follow objectives set by the government and limited by constitution, as is the case of most liberal states. In other cases, the military may be controlled by the state to pursue goals set by the government but not limited by constitution (or only formally limited).

The military may represent the “supporting elite” that keep rulers in power in resource-rich countries. In order to pay such support back, rulers make sure that the military is guaranteed access to some form of financing, be it official or illegal.

In some cases the military may act as the “guardian of the state”, controlling the agenda of the government: the most evident case is that of Turkey until the Eighties.

As for the involvement of the military in business, one may refer to two main categories. As outlined by Scheetz (2003), the first kind is that of “military- run industry”, involving some form of import substitution industrialization (ISI). The second is “military business”, constituted by enterprises with no ISI explanation, not intended to stimulate economic development, nor fostering arms-providing capabilities. It tends to concentrate on strict profit opportunities.

The element of political structure and its relation to the military is influenced by the dimension of transparency. Oil-related corruption impacts the government at every level. Some distribution policies, although theoretically appropriate, seem to encourage corruption, by putting funds at the disposal of politicians of questionable morality (Bennet 2002). Under some circumstances oil funds also seem to encourage corruption (Ross 2002).

Any distributive or spending decision emanated from a ruling system may be useless if the environment is highly corrupt. Some researches describe transparency as a fundamental issue for the effectiveness of revenue distribution policies (Jerome 2004, Ross 2002, Collier & Hoeffler 2002 among the others). It seems that an increased transparency may: reduce the sense of “unfairness” that many citizens tend to feel concerning revenue distribution; facilitate the work of auditors and international organizations, also helping to develop the right advices for a correct implementation of the policy; avoid funds being diverted to the financing of rebel groups (Humphreys 2003); and, pave the way for international funding and development programs by organizations such as IMF and the World Bank.

## 1.2 Why oil fuels nationalism

In the words of UCLA Professor Michael Ross, “The world is far more peaceful today than it was 15 years ago. There were 17 major civil wars - with “major” meaning the kind that kill more than a thousand people a year - going on at the end of the Cold War; by 2006, there were just five. During that period, the number of smaller conflicts also fell, from thirty-three to twenty-seven. Despite this trend, there has been no drop in the number of wars in countries that produce oil. The main reason is that oil wealth often wreaks havoc on a country's economy and politics, makes it easier for insurgents to fund their rebellions, and aggravates ethnic grievances. Today, with violence falling in general, oil-producing states make up a growing fraction of the world's conflict-ridden countries. They now host about a third of the world's civil wars, both large and small, up from one fifth in 1992. According to some, the U.S.-led invasion of Iraq shows that oil breeds conflict between countries, but the more widespread problem is that it breeds conflict within them”<sup>20</sup>.

The area of conflict prevention in resources-rich economies has become more and more important in recent times. Left “alone” by the fall of the Cold War blocs, some regions slipped back to the darkest pages of their post-colonial history, with tribal fights monopolizing the political scene, and a persistent lack of consideration for general social issues by leaders.

Some governments are indeed spending all their efforts to achieve a lasting peace, yet the oil price boom of 2002-2008 (from 22 to 146 USD, or a 660% increase) tested the resilience of producing states to the extreme. In Nigeria, for example, nominal GDP per capita is around 100 USD per month: a quick oil-bunkering<sup>21</sup> action can provide an individual some months’ worth of money, and can quickly fill the coffers of rebel organizations.

The 2008 oil price slump at below 40 USD exerted an equally disruptive influence on social stability for many areas, considering that governments and communities had planned budgets with reference oil prices up to 95 USD per barrel. The need to implement harsh and sudden budgetary cuts was deeply felt by local communities, as social assistance, subsidies, and infrastructural programs had to be scrapped. The effects of cheap oil were felt also at a national

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<sup>20</sup> Foreign Affairs of May/June 2008, *Blood Barrels*, at <http://www.foreignaffairs.com/articles/63396/michael-l-ross/blood-barrels>

<sup>21</sup> “Bunkering” is the illegal theft of oil from pipelines. Steel pipes are drilled and oil is collected. Such action expose citizens and terrorists to very high safety risks, and the operations are usually controlled by criminal organizations

level: Venezuela's President, Hugo Chávez, had planned a 2009 budget with a reference oil price of 60 USD, which was judged as rather conservative. The unexpected oil bust at 40 USD forced him to raise the value added tax and introduce significant spending cuts<sup>22</sup>: His popularity slipped from 61% in February (after winning a vote), to 52.8% in October, as registered by polls<sup>23</sup>.

Nevertheless, the mere presence of natural resources in a country or a region is not a sufficient element to determine the outbreak of conflict situations. Ross (2007) pointed out that "there are many cases of secessionist movements in mineral-rich regions; but there are other countries where no such conflicts occur, even though the preconditions exist. Careful studies of these successful cases may provide us with clues about ways that states can avert regional conflicts over mineral rents<sup>24</sup>". The presence of resource-wealth increases the interest of the central state towards the regional territory. If a "genuine" secessionist movement builds up, i.e. an uprising that is a real expression of local discontent, the central state may be strongly motivated not to grant independence, if oil and gas are present underneath the rebels' terrain. Therefore, with oil and gas, the "expected outcome" for the state by containing an insurgency is higher, resulting in expanded "political and military investments" to control the area. Local conflicts may be suffocated before they explode.

This is the main motivation that led Indonesia's President Suharto to declare the resource-producing province of Aceh a "Military Operations Area" in 1990: it was an expensive move, both in terms of budget and political responsibility, and was motivated by the need to preserve access to the area's precious gas reserves<sup>25</sup>. Also, Iran's policies towards its Eastern resource-producing province of Khuzestan are of this sort: the systematic plan of occupation and territorial fragmentation (also through physical means like walls and fences) aims at containing the development of a local organized political force.

But what drives independentist movements? To understand the motivations of secessionists in resource-rich regions, we shall distinguish between "regional resources concentration" and "regional inequality". The former concept

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<sup>22</sup> The New York Times, March 21, 2009, Chávez Trims Budget to Offset Low Oil Revenues

<sup>23</sup> Associated Press – Huffington Post, October 22, 2009, *Chavez Popularity Slips In Venezuela: Polls*

<sup>24</sup> Ross, Michael (2007), *How Mineral-Rich states Can Reduce Inequality*, in Humphreys, Macartan et al. (2007), *Escaping the Resource Curse*, Columbia University Press, p. 251

<sup>25</sup> Of course, gas was not the only motivation behind Suharto's decision to occupy Aceh. In the Nineties, Indonesia's national unity was challenged also by Papua and Timor (that eventually succeeded in its separation attempt)

describes the presence of resources in a distinct region, compared to the rest of the country: it is mostly related to the “geological wealth” of the region. We may take as an example, again, Iran: its recoverable oil reserves are about 130 billion barrels, and around 80-90% is located in the Khuzestan province. Some 110 billion barrels represent the “regional resource concentration”.

“Regional inequality”, can be defined as the “economic realization” of the geographical concentration of resources: citizens in the resource-rich region become richer than others, or vice-versa, because of a flawed revenue redistribution scheme. Khuzestan’s per capita GDP in nominal terms is around 2,000 USD, which is about one half of the average in the country: there is “regional inequality” that negatively affects the province.

Both “resource concentration” and “regional inequality” matter in the aggregation of discontent. Understandably, if a resource-rich region does not receive an adequate share of wealth, they may resort to protest. The region may revolt even if the rents distribution is fair, but it is not perceived as such by the population. This occurrence may be the result of far too optimistic expectations, or by outright campaigns by rebellious avant-gardes, seeking popular backing for their secessionist agenda. This occurrence is rather common: local populations tend to overestimate the reserves of their territory, and often build high expectations.

What seems to matter in influencing conflict is not the “actual” resource concentration or inequality, but rather such perception by the locals. Notwithstanding very high resources concentration, or a poor distribution policy, a conflict will not necessarily break out, if particular aspects in the social, cultural and ethnic contexts make a certain economic condition acceptable. For example, a region may host a culture with developed entrepreneurial sense, where the resource revenue may be invested for growth. Other regions may be more prone to turn into mere rent-seeking economies, increasing risks.

The central state may leverage a set of policies to contain rebellion and foster local satisfaction, ranging from financial and commercial regulations, to outright military intervention. We can broadly cluster policies into two groups: “Economic” policies and “Control” policies. Since cultural and ethnic contexts are fixed (or almost so), policies are the only levers a state directly controls.

By “Economic Policies” we mean any governmental, legal or statutory regulation which defines how revenue from oil and gas sale or taxation are spent and assigned to different levels of government and/or communities. By “Control Policies” we mean all the practices to regulate, direct, and contain the social and political dynamics of an oil or gas producing region. Such actions can be, for

example (Collier 2000): teaming up with the international community to curb foreign income for rebel organizations; developing policies to strengthen the civil rights of ethnic minorities, and avoidance of becoming sideline by the interests of larger communities; increasing transparency; undertaking military action to ensure security<sup>26</sup>.

We may consider the two elements as a practical application of Antonio Gramsci's distinction between hegemony and dominance<sup>27</sup>. In the first case, hegemony is expressed through the use a state makes of the revenue it can manage; in the second case, dominance is expressed by the control power it can leverage. As such, we may also anticipate that "Economic policies" seem to have an influence on the level of satisfaction of a region, and "Control policies" seem to influence the possibility for a rebellion to break out.

Specifically, the presence of natural resources and their relation to the uprising of a politically- backed rebellion is a new field of research in the area of the formation of nationalisms in post-colonial or pre-industrial societies. No rebellion can form, and no secessionist agenda can be pursued, in the absence of a separate cultural identity. The development of a rebellion-supportive local culture is more easily achieved if there is some sort of traditional or historical difference between the local and the main culture. For example, in describing the patterns of local conflict in Aceh, Indonesia, Michael Ross provided evidence that the GAM rebel organization leveraged the tradition of colonial rebellion to motivate its political agenda, aimed at the formation of Acehnese nationalism<sup>28</sup>.

The topic of nationalism is leveraged in this book, to explain why certain populations rebel towards other "central" ethnicities or political systems<sup>29</sup>: Collier & Hoeffler, based on the work of Benedict Anderson (1991), claim that the concept of nationalism as an "imagined community" is a building constituent of rebellions if it is "accepted by sufficient people to establish a functioning political organization capable of mobilizing votes, violence or both<sup>30</sup>".

In general terms, nationalism theories can be ordered into two main groups. The first one is termed "modernist", and assesses that nationalism, as a product

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<sup>26</sup> Collier, Paul (2000), *Economic Causes of Civil Conflict and their Implications for Policy*, The World Bank, pp. 16-22

<sup>27</sup> See Gramsci, Antonio (ed. 2001), *Quaderni dal carcere*, Einaudi

<sup>28</sup> Ross, Michael (2005), *Resources and Rebellion in Aceh, Indonesia*, The World Bank

<sup>29</sup> The connection between local nationalism and rebellion has been underlined, among others, by Ross (2003c) and by Collier & Hoeffler (2002b)

<sup>30</sup> Collier, Paul & Hoeffler, Anke (2002b), *The Political Economy of Secession*, University of Oxford/ Development Research Group – World Bank, p. 3

of modernity, is a political ideology which can spread in any society when the passage from an agrarian to an industrialized stage<sup>31</sup>; among the leading exponents of the modernist theory, we may mention Ernest Gellner, Eric Hobsbawm and on some extent Benedict Anderson. The second approach is defined “ethno-symbolism”, and it provides that nations are actual cultural entities that are broadly based on the existence of a sort of ancestral identity that defines the population. The main exponents of this approach are Anthony D. Smith, John Hutchinson and Manuel Castells.

The opposition between these two approaches was born contemporarily to the emergence of the concept of nation in the Eighteenth century. The philosopher Johann Gottfried von Herder asserted the centrality of nations in economic history and politics partially as a reaction to an Enlightenment’s thesis, that had forecasted the waning of nations in the long run. Von Herder believed that nations were a political expression of the self-identification of social groups<sup>32</sup>. Not by chance, the name of von Herder became popular again some 200 years after his death, as Eastern European countries started rebelling a the Soviet empire in the late 1980’s, in a wave of popular uprisings that were strongly nationalist in their identitarian terms.

The most relevant work in the field of modernist nationalism theory in the last decades is “Nations and nationalism” by Ernest Gellner (1983). The work explores the characteristics of the formation of nationalisms since the XVII Century, and provides a classical definition of it as “primarily a political principle that holds that the political and the national unit should be congruent<sup>33</sup>”. In order to explain how it tends to develop, Gellner introduces a distinction between “structure” and “culture”, two features of societies that have different roles in agrarian or industrialized systems.

In agrarian societies, a “structure” defines the different roles that people play, and the relationship between them. “Identities” of people are therefore determined by the “structure” of societies. In pre-industrial societies, cultures only represent a “concurring element” in defining identities: the basic reference pattern is represented by social structures.

Large-scale, complex agrarian societies do not allow the growth of nationalism because there are “structural” divisions that undermine its possibility

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<sup>31</sup> Pryke, Sam (2009), *Nationalism in a Global World*, Palgrave Macmillan, p. 33

<sup>32</sup> See von Herder’s work *Outlines of a Philosophy of the History of Mankind*, full edition available at [http://books.google.com/books?id=xKFmAAAAMAAJ&printsec=frontcover&source=gbs\\_ge\\_summ ary\\_r&cad=0#v=onepage&q&f=false](http://books.google.com/books?id=xKFmAAAAMAAJ&printsec=frontcover&source=gbs_ge_summ ary_r&cad=0#v=onepage&q&f=false)

<sup>33</sup> Gellner, Ernest (1983), *Nations and Nationalism*, Cornell University Press, p.1



of expansion. Social groups in agrarian societies are not in communication and cannot develop distinct cultural identity. Industrial societies are different, mostly because the occupational structure is not static, but is characterized by constant change. Structures do not define roles and identities. Identities are (or must be) defined by cultures, and nationalism is an expression of cultural identities in industrial societies.

As such, nations and nationalism are not “natural”, because they are not a permanent feature of the human social condition (although they are frequently perceived as such), but were born with the transition to industrialism. Neither are they arbitrary, nor avoidable: they have a “close, almost necessary link with industrialism<sup>34</sup>”. In particular, the modernist theory believes that nationalism is not a sentiment expressed by pre-existing nations; rather, it creates nations where they previously did not exist.

It is easy to find limits in the theory of Gellner: there are examples of nationalism which developed in agrarian societies, or industrial societies with no trace of nationalism. Yet, the influence of this theory is enormous, if we consider the assumption that: “Nationalism spreads unevenly, but this would not lead to nationalism if there is cultural homogeneity between the groups. If there is such potential, the better-placed groups have an incentive to use cultural differences to restrict competition for resources such as jobs, houses and schooling<sup>35</sup>”. This distinction plays a pivotal role when societies located in resource-producing regions seek the definition of a distinct cultural identity: fully artificial cultural identities are hard to implant.

The patterns of nationalism as “imagined community” (and therefore as a product of “ethno-symbolism”) is the topic of the work by Anderson (1991). A national community is “imagined” since its members will never “know” all the others, but in their minds there will be a concept of community which foresees an ideal connection with all the others. Together with Gellner, Anderson notices that the idea of nationalism is a rather new element in history. In particular, one of its central features is that this theory appears natural to those who profess it, although external observers invariably notice the characteristic of artificiality of nationalism. Anderson lists three “paradoxes” of nationalism. First, nationalism is a rather new element in history, although nationalists believe in its ancestral origin. Second, the concept of nationalism is universal, although its declination is

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<sup>34</sup> *Ibidem*, p. XXIII

<sup>35</sup> *Ibidem*, p. XXV

profoundly variable, nation by nation. Third, nationalism is very important and influential at a political level, yet it is rather “poor” at a philosophical one<sup>36</sup>.

These elements define how “nationalism” as a political system can be “injected” also into a territory with a rather poor historical tradition backing it. The strategy of fostering nationalism as artificial “political heritage” is particularly effective in those territories which feel the need to restrict the competition for power to people that are perceived to have similar characteristics. Like religion, nationalism is able to transform contingency into a project, and death into immortality. It is able to drive people to give up the immediate personal advantage to join up and struggle for a common, ‘higher’ goal.

Anthony D. Smith rejects the theory that nations are exclusively a product of modernity, and believes that they are a genuine product of culture<sup>37</sup>. In his view, national identities correspond with collective histories. Nations are not temporal artifacts that are subject to erosion: they are rooted in humanity. It is nevertheless possible for political elites and intellectuals to spend efforts and eventually succeed in nurturing the creation of a national identity, but in order to strike a popular chord and have it adopted and incorporated into a social identity, they must compete with older, pre-existing cultural sentiments that were found amongst ethnic forerunners.

Nevertheless, although it may be a “sincere” expression of cultural identity, local nationalism can represent a factor of risk for the stability of a resource-producing territory. Michael Hechter investigated how specific policies can help contain the most virulent aspects of nationalism, preventing its transformation into forms of rebellion<sup>38</sup>. Hechter believes that the problems of nationalism have a common cause, represented by an incongruence between the political and the national boundaries: “If nationalism is collective action designed to make the boundaries of the nation and governance unit congruent, then it can only emerge when there is a disjuncture between the boundaries of the nation and those of the governance unit. For the great bulk of human history no such disjuncture existed<sup>39</sup>”. Hechter criticizes the definition by Gellner, stating that “It is easy to think of counter-examples, however. Nationalism often arises in non-industrial settings: on the Indian subcontinent, in the sub-Saharan Africa, and in the hearth

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<sup>36</sup> See Anderson, Benedict R. O’G. (1983), *Imagined Communities: Reflections on the Origin and Spread of Nationalism*, Verso, p. 5

<sup>37</sup> Smith, Anthony D. (1986), *The Ethnic Origins of Nations*, Blackwell

<sup>38</sup> Hechter, Michael (2001), *Containing Nationalism*, Oxford University Press

<sup>39</sup> *Ibidem*, p. 36

of Central Asia. In some places (as in Catalonia) it unites different classes, while in others (the Basque Country) it divides them<sup>40</sup>". Hechter further adds: "What inhibited nationalism in the pre-modern state? The answer is "indirect rule". It thwarted nationalism because it often made the nation congruent with its governance unit<sup>41</sup>". The problem is, again: before 200 years ago, the "constant" structure was fixed, also at local level. Local governments functioned because they were hierarchical, not because they focused on local needs.

In particular, Hechter states that if proper policies of decentralization are applied, "nationalism is unlikely to develop for at least three different reasons. In the first place, [...] so long as the alien agent governs according to custom, [...] political conflict ought to be held in check. [...] In the second place, after several generations the alien agent is likely to become culturally assimilated to his subjects, if for no reason than the need to produce heirs. [...] In the third place, [the alien] still retains considerable control capacity over [the locals] because his territory is relatively small<sup>42</sup>". He recognizes that if a central nation imposes a "traditional agent" on a "mixed group", conflict may arise. Yet, in some cases, the strategies of political control by non-traditional agents have been tried in peripheral resource-producing regions, with some positive results.

Hechter believes that, "One solution is to grant nationalists their wish – self-determination. Since doing so would set a precedent that might unravel most existing states, however, this idea is a non-starter. Short of granting self-determination, nationalism can be mitigated by intervening in three general processes. The first of these is nation-formation. [...] This requires an appreciation of the underlying mechanisms responsible for group formation, group solidarity, and the development of national identity. Yet, the mere existence of nations has no necessary implications for nationalism. Nations that do not crave their own state apparatus pose no threat to the social order. Nationalism ultimately rests on the demand for national sovereignty. Hence a second means of containing nationalism is by reducing this demand. Conditions that contain the demand for sovereignty include the establishment of indirect rule and other state institutions that are responsive to the distinctive values of national groups.

A third means of containing nationalism consists in raising the costs of collective action. This strategy can be effective, at least for a certain time, even if

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<sup>40</sup> *Ibidem*, p. 36

<sup>41</sup> *Ibidem*, p.37

<sup>42</sup> *Ibidem*, p.44

interventions in the first two processes have failed or have not been attempted. The demand for sovereignty will not be very compelling if members of national groups face high costs of collective actions. These costs tend to vary both across time and between societies; they are largely determined by the state of the available technology, the society's political institutions, and by the nature of the geopolitical environment<sup>43</sup>”.

The case studies in this book show how solutions of self-determination in the case of the presence of natural resource may lead to very poor outcomes, if not adequately managed. A local nationalist movement, especially if based on ethnic and cultural patterns, feeds on new concessions – and the central rule still needs to retain a connection to the peripheral territory because of the need for resources. A solution to this problem, and a new interpretation of Gellner's theories, is presented in the conclusions of this work.

In terms of local identities, there is nevertheless some discussion whether the struggle by small- scale groups towards the recognition of political and cultural autonomy, should be defined as “local nationalism” or not. Hobsbawm opposes this theory. The current wave of “essentially separatist and divisive ethnic group assertion, that aims to break up existing nation states, has no positive programme or prospect<sup>44</sup>”. Instead, the tendency towards local self-determination and cultural identity should be understood as an expression of a general wave of insecurity and confusion felt by people who look for a ready target:

“The anguish and disorientation which finds expression in this hunger to belong, and hence the ‘politics of identity’ – not necessarily national identity – is no more a moving force of history than the hunger for ‘law and order’ which is an equally understandable response to another aspect of social disorganization. Both are symptoms of sickness rather than diagnoses, let alone therapy. Nevertheless, they create an illusion of nations and nationalism as an irresistibly rising force ready for the third millennium. This force is exaggerated by the semantic illusion which today turns all states into ‘nations’ (and members of the United Nations), even when they patently are not. Consequently, all movements seeking territorial autonomy tend to think of themselves as establishing ‘nations’ even when this is plainly not the case; and all movements for regional, local or even sectional interests against central power and state bureaucracy will, if they possibly can, put on the national costume, preferably in its ethnic linguistic styles<sup>45</sup>”.

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<sup>43</sup> *Ibidem*, p.18

<sup>44</sup> Hobsbawm, Eric J. (1992), *Nations and Nationalism since 1780 – Programme, Myth, Reality*, Canto, p. 170

<sup>45</sup> *Ibidem*, p. 177

Nevertheless, local struggles for political identities can be safely considered a form of nationalism. This assumption is consistent with the most widely accepted theories of nationalism, and in particular to Gellner and Hechter's, theories calling for political and administrative borders to be congruent. Moreover, "micro" nationalism is a contemporary expression of nationalism: since post-colonial times, most of the "large" nationalisms have already been more or less granted some form of autonomy. This is not the case for smaller ones, especially where natural resources are concerned. As evidenced by Dunaway (2003), referring to the Marxist theories of Immanuel Wallerstein, in local areas, economic production is transformed so that the zone becomes:

"dominated by capitalist relations of production, and inextricably articulated through complex commodity chains with the capitalist world-economy. That is, the means of production are captured by capitalists, the local economy is reorganized to prioritize export commodities, a surplus is extracted from cheap labor and ecological resources, and much of the surplus is drained to the core"<sup>46</sup>.

Also Castells (2004) recognizes that local political movements can be nationalist, since trans-national economic networks led to the resurgence of local nationalist identities that have all the features of "big" nationalisms. In particular, distinct from what was postulated by Gellner, a society whose territory is resource-rich may develop forms of local and/or ethnic nationalism, without having entered the phase of industrialization.

The development of resource-related nationalism constitutes a specific category of nationalism studies that must be explored in order to understand and possibly prevent its spreading. An increase in commodity price is often related to a recrudescence in civil conflicts. Given the expected rise in price of commodities globally, this issue may be at the center of speculation and policy-making in the area of conflict prevention in the next years.

### **1.3 What is known about oil and civil conflict**

Oil rents exert a direct impact on public policies. They expand the power or rulers, because they assign them the task of managing enormous (or, at least,

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<sup>46</sup> Dunaway, Wilma A. (2003), *Ethnic Conflict in the Modern World System: the Dialectics of Counter-Hegemonic Resistance in an Age of Transition*, *Journal of World-Systems Research*, IX, Winter 2003, p. 8

potentially enormous) sources of revenue. Petrodollars can contribute to the development of a country, allowing for the building of costly infrastructures, or the introduction of expensive social programs. Oil can be a country's damnation, facilitating extra-legal agreements between rulers and other subjects, the dictatorships (Ross, 2001), overspending and debt (Sachs, 2007).

The most common issues experienced by oil states have been listed by Terry Lynn Karl in her book "The Paradox of Plenty"<sup>47</sup>. The policy environment often becomes "petrolized": the production of hydrocarbons generates a set of policy problems related to the concentration of a country's social, political and economic life on the management of mineral resources. As a consequence, specific social clusters or classes are generated, together with organized interests that hinder change and make the introduction of fair policies more difficult. A rentier state is formed, characterized by a very large fiscal reliance on petrodollars, expanding state jurisdiction and weakening authority: control is substituted by trust and accountability.

The injection of oil weakens non-oil interests and fosters the emergence of new social classes and groups whose fortune is linked to the distribution of rents through state spending (Ikelegbe, 2001; Ross, 2003b). Sometimes a social "inverse pyramid" results: the larger part is formed by a generally unskilled and unproductive middle-class. This was the case, for example, of Venezuela between the '20 and the '30, when urban, middle class, outnumbered the working class (Freije, 2006). We may quote the example of Nigeria: a large part of the social stability is based upon the presence of an oil-fueled middle-class, whose salary is strictly dependent on the barrel price. Also in Iran, during the time of the Shah, oil rents were partially used to finance a system of companies termed "Bonyad", held by some fifty wealthy families, which provided political backing for the ruler. After the 1979 revolution, the system has been replaced by a "nationalized" structure, i.e. a set of fiduciaries controlling trade and industrial monopolies (also in the oil sector), providing cash to people associated with the theocracy or the Revolutionary Guards.

Social stability may be a hard goal to pursue within oil states, since the system still largely depends on the price of oil. Price swings may exacerbate petrolization, reinforcing public and private oil-based interests, and further weakening the reliability of the state. These effects characterize many countries exporting natural resources, but are particularly dramatic if the resource is oil

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<sup>47</sup> Lynn Karl, Terry (1997), *The Paradox of Plenty – Oil booms and Petro-States*, Studies in International Economy, University of California Press

(Ross, 2006). There is a strong influence of problems such as the “Dutch disease”, the theory according to which oil discoveries or favorable oil prices cause distress to other industrial sectors<sup>48</sup>. Oil exports prompt an appreciation of the national currency that makes imports more convenient than domestically-produced goods. As a consequence, industrial production in the country is depressed: only a wise and tight monetary policy can keep the currency balanced for example through USD-pegging. Yet, this solution leads to the formation of very large foreign currency reserves: to be invested in the domestic economy, they must first be exchanged into the national currency, causing again its appreciation.

Together with the “Dutch Disease”, oil-producing countries have to face and manage a whole set of variables that are not entirely under their control. Oil is the mineral that is mostly capable of generating extraordinary rents, yet its price is dependent on a global interconnected, volatile and unpredictable market, exposing the national economy to exogenous risks. Moreover, as oil barrels are shipped into the international market, reserve stocks are depleted: oil income can contribute to a long term, sustainable development only if it is invested in value-added sectors, or in plans aimed at improving social conditions (Devlin & Titman, 2004). All that is not invested, is lost.

Various studies focus on the importance of avoiding over-spending to make sure the national economy does not become overly oil-dependent (Collier, 2007; Devlin & Lewin, 2004; Ross, 2004b; Sachs, 2007). During oil price booms, political institutions must face increased pressure from stakeholders, and states are often not able to maintain a sustainable development policy plan (Stevens, 2003; Torvik, 2002). Lynn Karl (1997) and Auty & Mikesell (1998) were the first to introduce the “resource curse” concept. This idea derives from the observation that natural resource rich economies are often less developed than others. The “resource curse” is a building block of this book, yet this theory mostly concentrates on the problems that may be faced by producing countries as a whole: for example, commodity export may determine increased “vertical” inequality, together with a reduction in the size of the industrial sector in the whole complex of a country’s territory and population. This work mostly concentrates on the nature and the aspects of the relationships that connect a country with its producing region: this dimension is subject to specific problems and risks that differ from those faced by the central economy.

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<sup>48</sup> See Sachs, J.D. and Warner, A. (2001), *The Curse of Natural Resources*, European Economic Review 45

In general, quantitative studies agree on the fact that natural resources influence the outburst of conflicts and their duration, but there is no complete agreement about whether natural resources influence all types of civil war or only a subtype, and whether all kinds of resources are linked to conflict.

*Table 6 – Review of the most popular literature about quantitative analysis of resource related conflict*

<b>Research</b>	<b>Panel</b>	<b>Investigation focus</b>	<b>Finding</b>
Collier & Hoeffler 1998	27 wars, 1960-92	War onset	Oil increases likelihood
Collier & Hoeffler 2002b	48 wars, 1960-99	War onset	Oil increases likelihood
Collier & Hoeffler 2000	52 wars, 1960-99	War onset	Oil increases likelihood
Sambanis & Elbadawi 2002	108 wars, 1960-99	War onset	Oil increases risk of separatist wars only
Fearon & Laitin 2003	127 wars, 1960-99	War onset	No connection
Humphreys 2003	122 wars, 1945-99	War onset	Oil production increases risk, oil reserves do not

Ross (2006) considers a state “oil-rich” if the combined per-capita oil, gas and coal rents are above 100 USD per person, per day. In his analysis, the wars of petroleum-rich countries underwent two major conflict periods: 1960-73, with less than one armed conflict per year; and 1974-2002, with approximately 4.9 conflicts per year. The basic reason for this tendency is an increase in the number of oil states; nevertheless, such countries have become more prone to armed confrontation (from a rate of 0.067 in 1971-75, to 0.18 in 1981-85, after a drop -, the rate was .184 from 1995 to 2002<sup>49</sup>). Compared to other cases of civil war, the rate of oil-states suffering a resource-related civil conflict exceeded that of non-resource driven civil conflicts in 1999; in the same year, the overall number of oil conflicts beat that of diamond-fuelled ones, and held this unremarkable

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<sup>49</sup> Ross, Michael (2006), A Closer Look at Oil, Diamonds and Civil War, UCLA Department of Political Sciences



record up until 2002. Ross (2004b) again observed that “unlootable resources like oil, natural gas, copper and gold seem to make the onset of civil war more likely<sup>50</sup>”.

Ross (2007) later noticed that “many recent econometric studies find a correlation between the production (or export) of oil and the risk of civil war<sup>51</sup>”, listing at least ten cases where minerals played a central role in funding the spreading of secessionist movements. “The economic and social costs that result from such civil conflicts are extremely large; governments can avoid these costs by responding quickly to any rise in regional inequality<sup>52</sup>”. Ross (2008) also states that among developing countries, an oil-producing one is twice as likely to suffer from internal rebellion as a non-oil-producing one. The conflicts range in magnitude from low-level secessionist struggles, such as those occurring in the Niger Delta and Southern Thailand, to full-blown civil wars, such as in Algeria, Colombia and Sudan.

Also, Collier and Hoeffler (2000) found that the odds of civil war are significantly higher in resource-rich countries. Without natural resources, a country has 0.5% chances of being victim of an armed social conflict; if the resources to GDP share reaches 26%, the probability soars to 23%. These results are partially questioned by Ross (2006), who revealed how the reduction of non-oil GDP may be a consequence, and not a cause of civil war. Collier & Bannon (2003) made a direct comparison between the share of GDP represented by natural resources revenue, and the possibilities of civil war. At 25% of share there is a 30% risk of conflict; at 10%, the risk is 10%.

“Quantitative-based methods” must be integrated with considerations about specific cases and policies, since large generalizations risk overlooking the particular country’s conditions. Moreover, prediction of civil war probabilities is made difficult by a set of analytical constraints. Civil war episodes are “rare”<sup>53</sup>. Although resource abundance is a strong predictor for the incidence of civil war, either for greed and/or grievance reasons, further case-based research demonstrates that this link is not deterministic: policies can influence the

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<sup>50</sup> Ross, Michael (2004b), *Mineral Wealth and Equitable Development*, UCLA Department of Political Sciences, p. 16

<sup>51</sup> Ross, Michael (2007), *How Mineral-Rich states Can Reduce Inequality*, in Humphreys, Macartan et al. (2007), *Escaping the Resource Curse*, Columbia University Press, p. 245.

<sup>52</sup> Ibidem

<sup>53</sup> Some researchers (Fearon & Laitin, 2003; Fearon, 2005; Sorli, Gleditsch, Strand, 2005; Humphreys, 2005) tried to implement the “Logistic Regression in Rare Events Data”, by King & Zeng (2000), but results are not unanimous.

dynamics of resource-driven wars, as can contexts (Auty 2001 and 2003; LeBillon 2001 and 2004; Krug 2006; Ross 2005 and 2007).

“Case-base methods” focus on the study of the causation mechanisms that link the presence of natural resources to the outbreak of civil conflicts. They generally involve an empirical review of single civil conflict events, preferring the analysis of specific causation channels, rather than a quantitative review of general correlations. This is also the approach that has been chosen for this book, as quantitative methods may be reliable in defining general risk factors, but are less effective in defining how risk factors interact with a social and economic environment in determining situations of conflicts or peace.

The general findings of case-based methods suggest that resources can promote civil war through mechanisms such as:

Increasing the value of the state as a target: in the sector of resources extraction, the state retains a primary role, and is the keeper of economic values, which, in the most extreme scenarios, are transferable through a Coup (Fearon & Laitin, 2003)

- Increasing motivation by separatist movements: separatist forces may perceive that the benefits of directly controlling a resource-rich region are enough to engage in an armed conflict (Le Billion 2005)
- Increasing the funds at disposal of rebel organizations: in the oil sector, this is the case of money extortion by rebel organizations (Collier & Hoeffler, 2004)
- Weakening states in oil-driven economies: individualistic behavior may lead the state apparatus to be less invasive of economic life, to favor unofficial agreements. More generally, the institutions of an oil-state find their social justification on the situation of the oil market, and a price shock directly affects them. (Fearon & Laitin, 2003)

The interaction between oil-related inequality and the risk of civil war outbreak has been extensively investigated by Michael Ross, who analyzed the general effects of policy choices on countries at different stages of development. Ross states that defining a unique solution for all cases would not be appropriate, given the wide variability in societies and economies. The general recommendation of Ross is to create a “reputation competition” between oil exporting countries. An adequate approach would recommend general policies towards transparency, and the implementation of an “international system to rate the performance” of the oil rich countries. Ross’s theories have been carefully

considered (also through interviews), in order to build the present theory on previous research in the field.

Ross (2004b) describes a set of possible actions to avoid civil conflicts in mineral-rich countries; among them, fair distribution of revenue is included, together with transparency, respect for human rights, and presence of multi-stakeholders dialogue; the focus is different from the present work, that is more specifically focused on policy options, rather than best practices; and directly aims at the situations of extracting enclaves. Sachs (2007) provides an extensive set of advices to limit the risks of economic downturns due to the mismanagement of oil revenue. A useful analysis structure for the “traded / Non-traded” goods-related Dutch Disease is proposed, and has been quoted in the present research. Sachs uses a best practices list delivered by the IMF, originally intended for the management of foreign aid, and adapted to the effect of oil booms. Sachs is mostly concerned with the economic effects of oil rents management, and does not investigate the main research topic of the present research, related to the presence of extractive enclaves. The analysis is nevertheless useful, and has been leveraged to define the vertical effects of revenue management in the economy.

Humphreys & Sandbu (2007) analyze the best practices related to the well-functioning of “Natural Resources Funds” (“NRFs”). These funds collect the profits derived from the sale of natural resources through a national oil company, or directly paid by international operators. They allow an easier monitoring of the collection and the use of money, and permit an accountancy separation between “normal” state budget, whose income depends on non-oil taxation, and oil related income.

In order to work properly and really help avoiding problems of overspending and Dutch Disease, such funds need to be completed by precise rules in terms of the limits on the money that can be withdrawn every year. NRFs require some, “form of coordination between governments at different time periods, regarding, not simply, how much is spent, but also how it is spent<sup>54</sup>”.

Yet, deciding how much to spend at each period is anything but an easy task. Humphreys & Sandbu (2004) rationalized this issue through an “incumbent/challenger” model. The ideal outcome of spending and distribution policy is not that of making all groups better off. The authors suggest that people in power

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<sup>54</sup> Humphreys, Macartan & Sandbu, Martin (2007), *The Political Economy of Natural Resource Funds*, in Humphreys, Macartan; Sachs, Jeffrey D. & Stiglitz, Joseph E. (2007). *Escaping the Resource Curse*, Columbia University Press, p. 198

(incumbents) and the opposition (challengers) should commit *ex ante* to implementing the same compromise allocation in the first period; the value of which would exceed the expected, risk adjusted, value of the policies that may be implemented by the uncertain winner of the power contest. An additional solution involves inter-temporal smoothing of aggregate expenditure. A “challenging” politician could promise that, if elected, he would distribute a portion of the revenue to the other group. The incumbent politician would then find it, advantageous, not to spend all the financial resources during his mandate. Such kinds of agreements could significantly limit the degree of social tension due to tribal and group interests.

An important theoretical approach, often leveraged in the study of resource-related conflicts, is that of “greed and grievance”. Although this refers to a quantitative-based method, authored by Collier and Hoeffler (Collier & Hoeffler, 2000), the conceptual assumptions of their research had a large influence also on case-study based methods. In defining the causation channels of resource-related conflicts, a general distinction is introduced between “Greed” and “Grievance” led uprisings. The former describes the case of rebel organizations that enter a territory to seize its mineral wealth, and compares the militia to some kind of terrorist organization, not different from Somali pirates. “Grievance” uprisings occur in populations that suffer from underdevelopment, that rebel with the intention of gaining a larger stake of resource-related revenue.

Among other findings, Collier and Hoeffler state that vertical inequality (intended as uneven income distribution) does not seem to be a driving force in increasing the risk of conflict, and suggest that the financing of organized rebel forces is the main factor leading to war. Moreover, primary commodity exports increase extortion opportunities, making conflicts more likely.

Oil does not only have an influence on the increase of conflict risk, but also on the length of the confrontation. Ross (2002c) analyzes how commodities may lengthen conflict, by providing financial support to the weaker side, enabling and possibly motivating a longer armed confrontation. The worst case is when fighting factions engage in a “comfortable conflict stalemate” (LeBillon 2005), that is mutually beneficial and enables overriding of official rule, as long as it is needed to exploit the resources on the territory. In these cases, resources not only become a cause for civil unrest, but have an effect on lengthening conflicts as well. Resource wealth can weaken the application of cease-fire or peace agreements by local commanders. Ross (2002c) analyzed fifteen different resource conflicts, and reported how in all cases the war had been made longer by the financing of the weaker side of the conflict.

The management of oil rents during a conflict may be therefore leveraged to shorten clashes. If the largest and most powerful fraction has an interest in ending the war, it can exploit the resources to gain enough strength and convince the opponents to end the confrontation. This is the case with oil and the Angolan government: between 1999 and 2002, oil revenue allowed the state Army to reorganize and set up a campaign against UNITA. The main source of revenue for the rebels was diamond trading, but new UN regulations had become very effective in controlling it.

Besides the purely financial aspects of natural resources, Le Billon (2005) described how resources are more likely to be looted if they are spread over a larger territory, than if they are present just in a small area that can be easily controlled. "Point resources" are concentrated in a specific zone, and their extraction is very capital-intensive. But even if resources such as timber, alluvial gems and minerals, agricultural products and fish, are more likely to be looted by rebel forces, criminal organizations may exploit the wealth provided by unlootable resources by specializing in actions such as, threats to the extracting companies or to the government, kidnappings, and, illegal drilling of pipelines. In Colombia, for example, most of the oil flows from inland to the coast, through pipelines, and allegedly, oil companies pay around 100 million USD per year to guerrilla groups, and 250 million USD per year to the government as a form of compensation for the military expenditure to prevent terrorist actions (Pearce, 2004). Such attacks may also take place if oil resources are located off-shore, although as noticed by Ross (2004c) this case is less prone to conflict than on-shore oil.

There have been cases in Nigeria and in South Africa where protests have taken place even on off-shore platforms. In Nigeria, in 1998 a group of 100 people occupied a Chevron platform to demand jobs and monetary compensation for environmental damages; a year later, a small commando of the rebel group "Enough is Enough in the Niger River" kidnapped three Shell workers and hijacked a helicopter on a platform. In Angola, rebels in some occasions even had boats and helicopters at their disposal, crediting some parts of the South African army for supporting the UNITA guerrilla movement<sup>55</sup>.

In general, a government may leverage its greater access to resources to motivate rebel groups to defect and provide an incentive to peace negotiations. Resources, especially lootable ones, may lead to internal fights within rebel armies. A government may use its resource revenue flow to induce leaders to

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<sup>55</sup> Total Intelligence, May 2010, <http://www.totalintel.com/content/enough-enough-niger-river>

change sides. This specific feature has become pivotal in the post-political Cold War conflicts. Until 1991, the main conflict-financing source was covered by the main political blocks to the rebel organizations, with a “top-down” structure that allowed guerrilla leaders to retain grip on the locals. Nowadays, the flow is “bottom-up”, deriving from the commerce of looted resources, providing incentives for local leaders to defect (LeBillon, 2001; Ballentine & Nitzschke, 2005; Azam, 2002).

The aspects of financing and geographical distribution of resources also characterize the risk of conflict within producing enclaves. Ross (2004b) listed a set of factors influencing the outbreak of civil war. The first is poverty. Although partially contrasting the findings by Collier & Hoeffler (2000), Ross states that it is a decisive driver in fostering unrest. This difference of views may be explained by the fact that Collier & Hoeffler mostly focus on polarization, rather than outright poverty; and that poverty may foster unrest mechanisms different to the “secession” ones investigated by Collier & Hoeffler. Then, the presence of mountainous terrain seems to be linked to higher degrees of unrest, especially if the extractive region is separated from the rest of the country, or if it is in a peripheral area. As for prior regional identity, Ross believes that separatist movements may be encouraged by mineral wealth, but they do not seem to be created by it.

#### **1.4 Oil conflict to oil development**

If a regional government has reduced taxing authority on extraction profits, a booming mineral sector can have very little impact on the living standard of the local population. On the other side, if the local government can tax oil revenue, wages and employment can experience a boost. Alternatively, federal schemes can redistribute centrally collected revenues. In general, such “regional take” on profits may vary considerably. Aceh has the right to retain some 70% of profits from oil and gas<sup>56</sup>, while other central states simply do not grant any direct profit take to extractive regions.

But what is the optimal level of distribution? An oil revenue distribution approach is generally effective when it encompasses the needs of all the relevant stake-holders (Bennet 2002). Such stake-holders can be represented by regions, social classes or ethnic groups. A policy is effective if it is congruent with a

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<sup>56</sup> Indonesian Law 11/2006 on the government of Aceh

given situation, although after some time, a change in demographics, economics, local income or social structure may make the policy outdated. This means that policy-setting in this area is a continuous activity, rather than a “once for always” one.

Policies need to be tested for variable oil prices, immigration, market swings, and claims by communities. The capability of policies to quickly face such a volatile environment depends on the framework that is adopted to set policies. For example, an NRF with spending rules may help insulate the economy from oil price shocks, but may be too rigid in case coffers need to be opened to face a financial crisis: overrules may be difficult to implement. On the other hand, systems of central revenue collection (with powers of rapidly implementing disbursement decisions) may be more flexible, but may be more prone to misuse and overspending. In any case, it is pivotal to have effective communication between the various levels of government, in order to make sure that any spending decision responds to perceived social needs of the population.

A 2005 assessment by the World Bank analyzed the performance of NRFs<sup>57</sup>. The study evidences that the management quality of a resource fund is normally not different to that of the general economy: no fund is better than its government. In order to solve the issue of governance, the World Bank noticed that “while the highest quality of overall and sector governance may not be required for an extractive industry project to be beneficial to a client country, some minimum conditions should exist to help ensure that the benefits are not squandered<sup>58</sup>”.

The success of NRFs as a means to insulate economies from price shocks varies dramatically. Examples include Venezuela’s Stabilization Investment Fund, the state Petroleum Fund in Norway, Iran’s Foreign Currency Reserve Account, and the Oman General Reserve Fund. Rules for accumulation tend to be price-contingent (accumulation of revenue greater than at a target price), as in the case of the Chile Copper Stabilization Fund (CSF); or revenue-contingent (50% of oil revenue), as in the case of the Alaska Permanent Fund; or both (50% of all oil revenue above a reference price), and also, as in the case of Venezuela Stabilization Fund Rule. Withdrawal provisions have tended to be more discretionary than rules-based, in terms of transfers to the budget as needed

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<sup>57</sup> World Bank Operations Evaluation Department et al. (2005), *Extractive Industries and Sustainable Development*, The World Bank

<sup>58</sup> Liebenthal, Andres; Michelitsch, Roland & Tarazona, Ethel (2003), *Extractive Industries and Sustainable Development – An Evaluation of World Bank Group Experience*, MIGA IFC Operations Evaluation Group, p. 11

(Alberta, Kuwait, Kiribati, and others), with some control and oversight in most cases by the Ministry of Finance, central bank, and other government officials.

The variability in the efficiency of NRFs does not seem to depend on public participation of all stakeholders, i.e. on the presence of people monitoring their use. On one extreme we have the Alaska Permanent Fund, characterized by high levels of public involvement in the decision-making process concerning the establishment and evolution of the fund; public debate has influenced how the funds are spent, and led to the creation of a dividend program in which each citizen of Alaska is entitled to a share of the wealth generated from oil sales. At the other extreme, the Kuwait Reserve Fund for Future Generations is considered extremely non transparent since information about its holdings and expenditures is not available to public.

It seems that a fund works better if it relies on pre-existing adequate state institutions to run it. Norway, for example, is at an advantage because it had developed a mature democracy before the off-shore reserves were found. Institutions should be transparent in their management, not only for accountancy reasons, but also to stimulate public trust in the operations. As such, funds prove to be ineffective in curbing corruption, rent seeking and predation. Venezuela has been an example in this sense: as soon as rulers needed cash to finance budget expenditures, the national fund was raided in open disregard of its management policies<sup>59</sup>. Many scholars are therefore skeptical about the newly founded funds in Kazakhstan and Azerbaijan, or even the plan by the World Bank and the International Monetary Fund to set up a NRF in East Timor to manage the newly discovered off-shore reserves.

Recent research (Ross 2003) found evidence that resource funds are neither positive, nor negative for the finances of an oil-rich state. Even if funds are managed independently, political leaders often find ways to amend their rules, or to carry on a sloppy management of state assets, so that money from the fund can be used. Some evidence even suggests that funds may be harmful in some cases. If they are independent of the general budget of a state, they simply make the fiscal policies management too difficult, increasing also the risk of corruption and predation of resources. If they are not sufficiently independent, they can be used by rulers for transfers or even private use.

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<sup>59</sup> For a comparison between the performances of Venezuela and Norway, Bjerkholt, Olav & Niculescu, Irene (2004), *Fiscal rule suggestions for economies with nonrenewable resources: Norway and Venezuela* in George Kopits (ed.), *Rules-Based Fiscal Policy in Emerging Markets: Background, Analysis and Prospects*, Macmillan



Oil revenue funds should not then be implemented to heal fiscal management deficit of countries. Their value lies in the opportunity of increasing transparency and accountability. It should be designed, at least, to make it possible to keep track of what funds are accumulated, how they are managed, and how much is transferred to the fiscal authority, thus increasing public scrutiny of public finance in general, and of oil revenue in particular. Promoters of stabilization funds claim that they help maintain fiscal discipline by giving institutional backing to the idea that a boom should not lead to a spending binge; rainfall should be saved for future use. This could be important given the nature of the typical oil revenue regime, which often leads to opacity and corruption.

Devlin & Lewin (2003) traced some important guidelines that should be followed while projecting a fund to reduce volatility, taking into account that resource-rich countries can vary significantly in development and ethics. Funds should be managed by technical personnel: the ideal oversight is the Ministry of Finance, a board of directors, and/or the Central Bank. Benchmarks should be widely used. The case of the Norges Bank Investment Management is quoted; this institution was created to manage the Norway fund, and it is organized through “Chinese Walls” with the rest of the policy setting state departments, to avoid collusion and misspending.

The institutional design of the funds should make the earnings and use of resource revenue more transparent: this could be reached through the creation of pension funds, which should receive payments from the interest coming from the resource fund, or by engaging specific interest groups, such as environmentalists or traditional exporters.

Information on the fund’s activities should be publicly available and widely disseminated: Detailed annual reports should describe how the fund is administrated and include a list of the investments. Information on total return, benchmark return, and attribution of excess return, should be included, along with management costs. Where relevant, information on the selection process for external managers should also be included. In the case of the Norges Bank, an independent company hired by the Ministry of Finance, the company also makes calculations of the fund’s returns and provides an analysis of differences between actual and benchmark returns. These reports are also submitted to Parliament.

The size of the fund matters: due to economic and political reasons, larger funds can potentially incur more inefficiencies and distortions than smaller ones. Both theoretical and empirical evidence on the size of funds suggests that the optimally sized fund tends to be much smaller than expected, with the

determining factor being the statistical properties of oil prices, rather than rules for accumulation and withdrawal.

As for the political impact of NRFs, an important element to consider is the value of the funds compared not only to the national socio-economic system, but to the international economy and markets in general. When NRFs started up in the Seventies, they mostly served a “defensive” purpose, i.e. stabilizing the dynamics of internal economies. Soon thereafter, the governments of the producing countries realized that the amassed capitals could represent a viable mean of imposing an international strategy. The first evident outcome was represented by the Kuwait national fund attempt to buy a stake in the international oil company BP, as it was privatized by the UK premier, Margaret Thatcher, in the early Eighties. Thatcher eventually had to resort forbidding the fund to acquire majority participation. Nowadays, out of the first fifteen national funds worldwide, nine are based on the export of oil and gas<sup>60</sup>.

So, natural resource funds are not a solution “per se”. Complete and sound economic policies are needed. In case of oil booms, the export sector and the non-traded goods sector risk to crowd out the non-traded sectors, bringing instability to the national economy. Mineral-rich countries should therefore invest in “economic diversification” to avoid this problem. The risk is that, if the price shock reverses, the national economy would no longer be able to satisfy the needs for the goods that were imported – and that before the oil boom were (often) produced by the local industry. Davis (1995) regards it as one of the most important issues concerning oil-exporting countries: from the Sixties to the Nineties, many investments were made to promote non-oil sectors, but in some cases, rulers simply lacked the technical ability to decide which portfolio of options best suited the country’s needs. Nevertheless, economic diversification remains the basic rule to avoid downturns.

The element of diversification concerns not only the need to diversify the private sector, but also the necessity to avoid an oil monopoly as the source of revenue of the state. Most oil-producing states recognize the need to develop a significant, non-oil revenue base, to minimize the variability of revenue in case of market downturn. Concerning the investments a state could make to reach the goal of economic diversification:

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<sup>60</sup> The Washington Post, Top Sovereign Wealth Funds,  
<http://www.washingtonpost.com/wp-dyn/content/graphic/2008/03/27/GR2008032700749.html>

“two potential pitfalls tend to be particularly important. The concentration of fiscal resources tends to encourage excessive and imprudent investment: the state implements large projects without sufficient participation of private co-investors to provide a screen against excessive risk. Some ways of distributing rent, whether through sustained protection of favored activities or firms, or a combination of non-oil taxes and subsidies and public spending, have high deadweight costs and encourage corruption. In some cases, very low non-oil taxes might be useful as part of a rent-distribution strategy, though this approach should be combined with measures to strengthen tax administration to diversify potential revenue sources to create a buffer against oil revenue fluctuations. Cheap domestic energy could be one element of such a strategy (particularly in times of high world energy prices), but needs to be viewed in the wider context of non-oil taxation<sup>61</sup>”.

There are many examples of countries that are benefiting from this approach: Kuwait, the UAE and Malaysia, to name a few. There is also the surprising case of resource-exporting in Botswana, which in 30 years moved from being the 25th poorest country, to an upper-middle income one<sup>62</sup>. Many others fail. The problem is that governments are excessively short-term focused, and therefore lack the incentives to run fiscal policies that may appear unpopular in the short run. Success lies in some combination of expenditure-restraint and revenue management, the latter consisting of self-insurance and asset diversification. The aim of these approaches is to eliminate instability in aggregate demand, and consequently the real exchange rate, by smoothing expenditure over time. This implies that the economy becomes self-insured towards revenue downfalls. The ability to maintain expenditure during price busts depends on previous prudence during the boom. Alternatively:

“...oil-producing governments can transfer oil price volatility to private markets by using financial instruments to hedge oil price risk. This approach tends to work better with a combination of short and long-term instruments that provide opportunities for hedging (such as options and futures), along with asset diversification (through the use of commodity bonds). However, few countries systematically manage commodity risk with financial instruments - although there are success stories in this regard. Insulating the economy from oil price volatility will, other things being equal, allow the non-oil sector to accumulate productive assets through the normal process of saving and investment, thus effectively supplementing the volatile revenue with a more stable source of income over the medium to long term. It is also worth noting that fiscal policy is determined by the consolidated government transactions. Saving all the oil revenue (such as in an oil revenue fund) does not in itself indicate the net accumulation of assets by the government, as this can be offset by

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<sup>61</sup> Eifert, Benn et al. (2003), *The Political Economy of Fiscal Policy and Economic Management in Oil-Exporting Countries*, in Davis, Jeffrey M. et al. (2003), *Fiscal Policy Formulation and Implementation in Oil Producing Countries*, International Monetary Fund, p. 86

<sup>62</sup> World Bank report, Botswana Country Brief, 2010

the accumulation of other liabilities. In monitoring the fiscal stance of a country it is therefore important to monitor the consolidated debt/asset position of the government<sup>63</sup>.

A goal that can potentially be set by the state is that of compelling the non-oil deficit to be consistent over time, with the sustainable permanent component of oil revenue (i.e. the one that would reasonably not be impacted by a price shock). A certain amount of deficit would therefore be made acceptable while planning state finances, and would be covered by a stable item. Critics may argue that this kind of financing is still a deficit. Devlin & Lewin (2004) proposed a solution to this dilemma by mentioning the mechanism of “substituting oil assets with physical assets”. The problem with these kinds of approaches, nevertheless, is that oil prices have soared so significantly in the last years that the “stable” component of oil prices has become too high to be absorbed by the economy with manageable effects. Prices have soared too rapidly to be administrated without some form of insulation, even if the risk of a total price bust is to be reasonably excluded.

It should now be clear that, in order to avoid fiscal management problems, there is no “one size fits all” solution. Everything depends on the economic history and the discipline of the country. The case of dictator Suharto in Indonesia is considered an example of an “enlightened dictator” (despite a certain passion for bribes), which helped the country to develop, to some extent<sup>64</sup>. The problem is that the world, for better or for worse, simply lacks enough dictators of this sort, to be put in power, as most seem to automatically become rent-seekers as they gain power.

But how bad is rent-seeking and over-exposure to oil rents? Liuksila (1994) proposed a quantitative analysis to assess whether a fiscal policy of a rentier state is sustainable or not. The concept is to adopt a framework which takes into account the “permanent income” that considers the total wealth of a government, including the portion coming from the extraction of natural resources. A welfare-maximizing fiscal policy would leave the present value of government net worth, unchanged for a given desired long-run level of net worth. For example, a decision to reduce entitlement payments should improve government net worth over the long run, by lowering the stream of future government liabilities. This result could leave room to lower taxes, or reduce the stock of government debt,

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<sup>63</sup> Devlin, Julia & Lewin, Michael (2005), *Managing Oil Price Risk in developing Countries*, in Aizenman, Joshua (2005), *Managing Economic Volatility and Crises: A Practitioner's Guide*, Cambridge University Press, pp. 192-194

<sup>64</sup> See Schwarz, Adam (1997), *Indonesia after Suharto*, Foreign Affairs, Vol. 76, n.4

and thus, further other policy goals. As long as the government net worth is positive, the government is regarded as solvent and can meet its future obligations. However, when the government is barely solvent, the net worth is close to zero, and the perception of near insolvency could be reflected in the need to pay higher interest rates or a risk premium on government debt, thus pushing the government into actual insolvency. In this case, policy action would be required well before insolvency had been reached.

This element of disciplined monetary policies is fundamental, and represents the backbone of a sound oil-rent management system. The easiest strategy is that of pegging the domestic currency to the USD, which is the trading money for oil. A preferred solution for every exporting country since WWII, it is proving now, its limit, as the US currency depreciates towards other currencies; and as the US interest rates are kept too low to counter the strong inflationary pressures coming from the rising commodity prices. In 2005, Malaysia switched from USD peg to a value assessed from a basket of currencies; the Niggit appreciated significantly, but now the country has an additional instrument to curb inflation, represented by the possibility of setting personalized tailored interest rates. Prices increased around 2% in 2005, and were close to 4% in 2007<sup>65</sup>. This may prove a viable solution if the dollar will not ensure a stable protection from monetary outbursts in the following years, although it would require significant ability to manage the domestic currency.

However, also the disciplined management of a natural wealth fund, together with a wise monetary policy, are not enough, if not complemented by an adequate distribution policy, capable of considerably and satisfying all stakeholders. Proposed solutions vary consistently. Studies by Ahmad & Mottu (2003) suggest that all oil revenue should be centrally managed: the researchers argue that central states have better technical skills to decide how resources should be invested, and how to impose taxes, also on extraction. Central states also have a better general view of how the redistribution aspects should be administered, in order to prevent that the producing enclaves or the other regions feeling spoiled. The reason to allow subnational governments to levy taxes is mostly political, and responds to the need for avoiding secession. Local rulers and citizens may be satisfied by the right to impose fiscal burdens on the assets coming from their territory. The problems of coordination with the general state spending and fiscal policies would still remain.

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<sup>65</sup> World Bank and CIA World Fact book data, 2010

As evidence for successful centralized policies, we may quote the cases of all rich oil states in the Gulf region, with the exception of the UAE. Outside the Middle-East, however, both unitary states (Ecuador, Colombia, Kazakhstan) and federal states (Mexico, Nigeria, Russia, Venezuela and Indonesia) adopt some form of revenue-sharing. The best policy option should therefore be that of centralizing all revenue, and creating arrangements for the redistribution of wealth among the local population.

If this solution is not possible, the second that seems to best fit the needs of economic development, is to let local governments impose specific taxes, like production excise taxes, while the central government retains the power to impose other taxes characterized by a higher volatility. There is also the alternative of revenue-sharing arrangements that avoid the difficult situation of asking local governments in developing countries to set their fiscal policies. These actions can harmonize state fiscal policies. This solution should be tested more thoroughly, in particular regarding the effects it could have on the build-up of secessionist movements. There is, however, no evidence that it could foster violent secessionist conflict.

Weinthal & Jones Luong (2006) suggested that oil money could be directly distributed to citizens, as in Alaska. The implication is that people would “act rationally” and choose the investment opportunities which would best fit the need to avert the dangers of the Dutch Disease. The risk of this approach is simply that people may seek consumption, more than an investing behavior. Nevertheless, citizens would also be more interested in monitoring this significant source of revenue. There would be a strong social pressure towards transparency, increasing the overall management of this wealth. This goal could be reached by a minimal redistribution of revenue, with insignificant impacts on the economy, but reaching a widespread level of social interest.

The supporters of this approach believe that dispensing rents at the lower government levels could also discourage rent-seeking activities. They imply that in the developing world, national politics are characterized by corruption and coercion, but local politics are characterized by fairness, equity, and transparency. Yet, this claim is disputed: in many developing countries, coercive organizations exist at all levels of society. Case studies have shown that protection rackets, shakedown operations, for-profit rebel armies, and similar mafia-type organizations can extract rents at the local level. To imagine what decentralized rent-seeking might look like, states with large deposits of alluvial diamonds, like Sierra Leone, Liberia, Angola, and the Congo shall be considered: each suffers from grassroots-level rent-seeking and endemic conflict.

An alternative, “extreme” approach concerns the private ownership of the oil revenue: “Robust institutions are the product of both supply and demand; governments must have an incentive to supply them and societal actors must have both the interest and ability to make a credible demand for them. In the majority of mineral-rich states in the developing world, however, neither condition is met. State ownership, in particular, creates a disincentive for introducing institutions that would limit the government’s fiscal independence or discretionary decision-making power. It also undermines the development of societal actors that are either powerful enough to challenge the state, or have a keen interest in limiting its power. Not surprisingly then, the vast majority of mineral rich countries have exercised state ownership over their mineral reserves from the late Sixties to the early Nineties—the very historical time period on which most of the literature on the resource curse focuses<sup>66</sup>”.

Russia represents evidence for this position by Weinthal & Luong, as private companies have stepped in to take the role of the state in managing and distributing oil wealth. The authors mention that the industry expanded, and although the model has to be perfected, still represents an option for rapidly building up extractive and managing capacity. The approach by the authors seems widely questionable when assessing that “Unlike state companies, in private companies managers are compensated, based on performance, and the owners have a direct claim to profits, and thus, both owners and managers are primarily concerned with profitability<sup>67</sup>”. This may not be a universal rule.

Oil wealth management is a task that cannot be handled by governments alone, and must include the participation of different stakeholders. International Finance Institutions could plan a common strategy with oil companies, to share the risk of oil prices on developing producing countries. This idea by Devlin (2004) is inspired by the fact that the major oil companies actually produce more oil than the OPEC countries, and therefore could be chosen as the main regulators of prices in the sector. Although this assumption is prone to various criticisms, the most acceptable point is that private extracting companies have a significant role in helping host-countries to develop, ensuring also the stability of private operations. Social stability is not only in the interest of producing countries.

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<sup>66</sup> Weinthal & Luong (2006), *Combating the Resource Curse: an Alternative Solution to Managing Mineral Wealth*, Duke University, p.42

<sup>67</sup> *Ibidem*, p.45

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