



## *MISSION IMPROBABLE*

Does petroleum-related aid address corruption in resource-rich countries?

Ivar Kolstad, Arne Wiig, Aled Williams

**U4 ISSUE 3:2008**



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## U4 Issue

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## Abstract

Petroleum-related aid programmes and projects are a key part of donor activities in oil-rich developing countries. This U4 Issue explores the petroleum-related activities of three bilateral donors: Norad, CIDA and USAID. While governance issues are beginning to receive more attention in these types of programmes, they still form a minor part of programme activities. The petroleum-related aid activities of the donors in question address the issue of corruption only to a limited extent. Given the commercial and political interests of donor countries, questions about the integrity and credibility of these types of programmes can be raised. Moreover, the narrow, sector focus of these programmes makes it unlikely that they will produce the institutional changes needed to lift the 'resource curse'. The paper is part of the project 'Corruption in Natural Resource Management' at the U4 Anti-Corruption Resource Centre: [www.u4.no/themes/natural-resources/main.cfm](http://www.u4.no/themes/natural-resources/main.cfm)

# 1 Introduction

Many resource-rich developing countries suffer from a phenomenon called the ‘resource curse’. Paradoxically, rather than create prosperity, an abundance of natural resources often leads to lower growth rates, lower levels of human development, and more inequality and poverty (Sachs and Warner, 1995; Bulte et al, 2005; Gylfason, 2001a). In particular, the natural ‘resource curse’ occurs in countries rich in certain types of resources, generally termed ‘point resources’, which include oil and gas. In view of this, a number of donors have introduced petroleum-related aid activities in developing countries rich in oil and/or gas. Though these types of activities may constitute only a small proportion of total aid budgets, some donors have designated petroleum-related aid an area of priority, such as the Norwegian government through its Oil for Development programme. Moreover, in certain oil-rich developing countries, petroleum-related aid constitutes a significant proportion of total aid received.

Petroleum-related aid can be defined as activities aiming to improve the development impact of petroleum resources, i.e. oil and gas. This U4 Issue explores the petroleum-related aid activities of three bilateral donors – Norad, CIDA and USAID – with a view to assessing their likely effect on the ‘resource curse’ more generally, and on corruption specifically. While only Norad is targeting its activities through a single programme (the Oil for Development programme), the two other donors have a number of petroleum-related aid projects, which are helpful to include to establish a fuller picture of petroleum-related aid. There are also other donors that have activities related to petroleum, such as the World Bank and DFID, but these are not included in the present study.

Recent research into the ‘resource curse’ has identified institutions as a key variable in determining whether a country benefits from its natural resources or not. In particular, institutions that curb patronage (the distribution of rents for political purposes) and rent-seeking (the socially costly pursuit of rents), are identified as important in improving the development impact of natural resources (cf. section 4 for details). Since patronage and rent-seeking can be viewed as forms of corruption, this also means that addressing corruption is central in helping resource-rich developing countries escape the ‘resource curse’ (Kolstad and Søreide, 2008).

For petroleum-related aid programmes to have a significant impact on development in oil-rich countries, it is imperative that their activities reflect the policy implications of recent research and that the programmes aim to build or strengthen the right kind of institutions. To assess the extent to which existing programmes do so, and suggest areas of improvement, this paper reviews current theory and evidence on the ‘resource curse’ and on corruption, and discusses current petroleum-related aid activities in light of this. Information on current activities in this area is based on contact and in-depth interviews with programme staff on their activities and priorities. Given the constraints of the paper we have not collected information from other stakeholders or performed detailed evaluations of specific projects of the donors included.

The paper is structured as follows: Section 2 provides a descriptive overview of the petroleum-related aid activities of the three donors (Norad, CIDA and USAID) in turn. Given that donors of petroleum-related aid are often oil-producing countries with clear commercial interests in the oil sector, and given the geopolitical importance of oil, section 3 discusses the importance and implications of securing the integrity of petroleum-related aid flows and activities. Section 4 reviews the main theories in the ‘resource curse’ literature, and discusses their relative empirical basis, concluding with implications for policy in terms of improving institutions in oil-rich countries. Section 5 takes a more detailed look at corruption, and discusses how petroleum-related aid should address this issue in oil-rich countries. Section 6 provides a concluding discussion of the findings and some policy implications.

## 2 Overview of petroleum-related aid programmes

A number of donors have petroleum-related aid programmes or projects. The ways these programmes are organised vary, as do their activities in terms of general capacity development and more specific anti-corruption efforts. This section provides an overview of three bilateral donors (Norad, CIDA, and USAID) and their activities in this area. The subsection on each donor is structured to feed into discussions in sections 3, 4 and 5 of this paper, respectively. First, information is provided on the size of the programmes, their allocation across countries, and their organisation and allocation procedures. Second, an overview is given of the types of institutions aid is directed towards (broadly categorised into macro-economic management, resource management, environmental management, governance/accountability and private sector development), and the analyses underlying the approach taken. Third, the more specific anti-corruption efforts of these programmes are summarised, including, where possible, analyses informing these efforts.

### 2.1 Norad: Oil for Development

Norway has provided petroleum-related aid since the early 1980s. In 2005, the Oil for Development programme was launched in an effort to coordinate and extend this type of assistance.<sup>1</sup>

#### 2.1.1 Allocations and organisation of the Oil for Development programme

The total budget of the Oil for Development programme was about US\$ 31.6 million in 2007. The programme is one of the Norwegian government's areas of priority in development cooperation, and the programme budget is indicated to increase by about 44% to about US\$ 45.6 million in 2008. The country allocations for 2008 are given in Table 1 below. As the table shows, the programme allocates funding to activities in 25 countries in 2008. The bulk of the funding goes to long-term programmes in 10 countries, whereas projects in the other countries are more short-term. The biggest recipients in 2007 were East Timor and Iraq, while in 2008, the heaviest funding will go to activities in Sudan, East Timor and Angola. The right-most column in Table 1 indicates countries where the dominant Norwegian oil company StatoilHydro has operations; superficially, the overlap with the Oil for Development programme appears limited.

The Oil for Development organisation consists of a Steering Committee and a Secretariat. The Steering Committee is chaired by a representative of the Norwegian Foreign Ministry, and has members from the Ministry of Petroleum and Energy, the Ministry of Finance, and the Ministry of Environment. The Secretariat is located at Norad and employs eight Norwegian nationals of relatively varied disciplinary backgrounds: three have worked in Norwegian oil companies (including the programme manager), and one in an international oil company. The decision-making procedure formally consists of three stages: the establishment of a platform for dialogue with a partner country, followed by a set of analyses including a risk analysis, before a cooperation agreement is established with the country in question. Funding for long term programmes are allocated over embassy budgets, whereas short term projects are funded over the programme budget. Though the programme management is responsible for the allocation of the latter funds, actual allocations appear to be made in extensive consultation with the steering committee. In this way, Norwegian foreign policy has considerable influence on the country allocations of the programme.

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<sup>1</sup> Oil for Development Programme, Norad: [http://www.norad.no/default.asp?V\\_ITEM\\_ID=10094](http://www.norad.no/default.asp?V_ITEM_ID=10094)



*Table 1. Oil for Development country allocations 2007-2008 (budget as of 16 November 2007, in US\$1000)*

	USD 2007	USD 2008	StatoilHydro Presence
	Prognosis	Prognosis	
<b>Main partner countries</b>	<b>17 262</b>	<b>22 464</b>	
Angola	2 013	3 910	Yes
Bolivia	258	921	No
Madagascar	1 100	1 658	No
Mozambique	2 191	2 173	Yes
Nigeria	1 231	1 216	Yes
Sudan	1 669	4 586	No
East Timor	3 459	3 929	No
Uganda	1 932	885	No
Iraq	2 587	1 749	No
Vietnam	829	1 436	No
<b>Potential new main partner countries</b>	<b>1 443</b>	<b>3 463</b>	
Afghanistan	719	1 105	No
Lebanon	723	1 252	No
Ghana		1 105	No
<b>Countries with limited cooperation</b>	<b>2 798</b>	<b>6 776</b>	
Bangladesh	101	921	No
Ecuador	129	294	No
Ivory Coast	0	921	No
Indonesia	276	92	Yes
Cambodia	867	866	No
Kenya	6	368	No
Mauritania	66	0	No
Nicaragua	0	184	No
Palestine	147	552	No
São Tomé	37	284	No
South Africa	92	506	No
Tanzania	264	368	Yes
Zambia	55	368	No
CCOP <sup>2</sup>	757	921	-
EAPC <sup>3</sup>	0	129	-
<b>SUM country allocations</b>	<b>21 503</b>	<b>32 703</b>	
<b>Not allocated to specific countries</b>	<b>9 968</b>	<b>12 674</b>	
<b>Sum total</b>	<b>31 471</b>	<b>45 377</b>	

*Sources: Oil for Development and StatoilHydro*

<sup>2</sup> The Coordinating Committee for Geosciences Programs in East and Southeast Asia

<sup>3</sup> The East African Petroleum Conference

The Oil for Development organisation consists of a Steering Committee and a Secretariat. The Steering Committee is chaired by a representative of the Norwegian Foreign Ministry, and has members from the Ministry of Petroleum and Energy, the Ministry of Finance, and the Ministry of Environment. The Secretariat is located at Norad and employs eight Norwegian nationals of relatively varied disciplinary backgrounds: three have worked in Norwegian oil companies (including the programme manager), and one in an international oil company. The decision-making procedure formally consists of three stages: the establishment of a platform for dialogue with a partner country, followed by a set of analyses including a risk analysis, before a cooperation agreement is established with the country in question. Funding for long term programmes are allocated over embassy budgets, whereas short term projects are funded over the programme budget. Though the programme management is responsible for the allocation of the latter funds, actual allocations appear to be made in extensive consultation with the steering committee. In this way, Norwegian foreign policy has considerable influence on the country allocations of the programme.

### 2.1.2 The institutional focus of the Oil for Development programme

The Oil for Development programme has its focus on three “main integrated themes”:<sup>4</sup> resource management, revenue management, and environmental management and control. These three main themes account for almost 90% of country allocations, with resource management being dominant and amounting to more than two-thirds of this percentage. Previous evaluations of Norwegian petroleum-related aid have pointed to a lack of governance activities (Ekern, 2005), which has led to more activity in this area. Apart from governance activities in country allocations, in 2008 the programme will allocate US\$3.7 million to civil society, and also channel funding to the World Bank Petroleum Governance Initiative.<sup>5</sup> There is some activity on enhancing local content and spill-over from the petroleum sector, but not on private sector development more generally.

The majority of the programme’s activities are directed at enhancing the capacity of government and civil service staff. This probably reflects the programme’s emphasis on being demand-driven, where demand largely means government demand. It is, however, apparent that activities also reflect the available supply of Norwegian competence. No systematic or standardised analysis of the political economy of recipient countries is performed – this is done only sporadically in some cases. There is awareness among programme staff, however, that institutional reform is easier to accomplish in countries entered at an early stage of resource extraction. A recent evaluation of Norwegian petroleum-related aid to four countries concludes that “the strict petro-technical capacity building in the programmes to a high extent has been successful, in particular in the ‘new’ petroleum producing countries. Institutional capacity development has been less successful” (Norad, 2007:5). The evaluation also notes a disconnect with Norwegian development cooperation policy, since the “programmes seldom address poverty reduction explicitly”, and “have seldom been followed by targeted efforts to ensure that the petroleum revenue enters the state budget and leads to a poverty-oriented redistribution of resources” (p. 4).

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<sup>4</sup> Three main integrated themes: [http://www.norad.no/default.asp?V\\_ITEM\\_ID=10060](http://www.norad.no/default.asp?V_ITEM_ID=10060)

<sup>5</sup> The Petroleum Governance Initiative is a bilateral collaboration of the Government of Norway and the World Bank aimed at achieving structured cooperation on petroleum governance issues, particularly support to developing countries in implementation of appropriate petroleum governance frameworks, including resource and revenue management. See <http://go.worldbank.org/EHCABA2FU0>

### 2.1.3 Anti-corruption activities of the Oil for Development programme

The main anti-corruption approach of the programme appears to be support to civil society, though it is unclear to what extent this support is specifically about corruption. This type of support has increased considerably in 2008. Civil society funding is channelled through Norwegian and international NGOs, who have collaborating organisations in the partner countries. These local partners are suggested by the Norwegian and international NGOs, and the programme checks their appropriateness, especially in terms of petroleum-related focus and capacity. There appears to be little analysis of whether the conditions are in place in the partner country that would make civil society support the most appropriate anti-corruption approach, or of political economy considerations more generally. In some isolated cases the programme has provided support, for instance, to enhancing the capacity of e.g. parliaments. The programme also notes its links to the Extractive Industries Transparency Initiative (EITI)<sup>6</sup>, whose secretariat is located at Norad.

The risk analysis conducted prior to project implementation follows standard Norad procedures. It includes corruption as an element, but only addresses project-specific risks, rather than corruption problems in the partner country more generally. We have been informed that no country has been denied funding based on the risk analysis, but that there have been instances of a freeze of ongoing projects, whereas high levels of risk result in a different mode of implementation where the influence of partner country governments is restricted. The programme thus has activities in highly corrupt countries.

## 2.2 CIDA programming in oil and gas sectors

Canada has provided support to oil and gas sectors in developing countries throughout the past 30 years. Unlike Norad, it does not deliver support through one programme with an international reach. Rather, it provides support through bilateral programming, but also through its regional programmes, via two divisions of its Canadian Partnership Branch and through its support of various multilateral programmes.

### 2.2.1 Allocations and organisation of CIDA programming in oil and gas sectors

Since 1990, CIDA has made a total contribution in excess of US\$360 million to oil and gas sector support. Over the past two years, allocations for both oil and gas have been approximately US\$10 million per year, with around 30% of this figure devoted to oil sector support. The allocations for recently completed and ongoing projects are given in Table 2. The right-most column indicates countries where two of the largest Canadian oil companies, EnCana and PetroCanada, operate.

The bulk of bilateral programme funding has gone to Bolivia, Peru and Pakistan. Significant allocations have also been made via the Industrial Cooperation Division, with the majority of this funding going to countries in the Americas and Asia, for example Brazil and Bangladesh. CIDA organises its cooperation primarily through its bilateral and partnership branches. In terms of bilateral programming, specific projects are identified and agreed upon with partner countries as part of the five year Country Policy Framework Process. Once this is in place, a bidding process leads to the appointment of a Canadian Executing Agency (CEA) – often a Canadian private sector firm with an international reputation – for which annual work-plans are established. These work-plans are approved by a Steering Committee consisting of representatives of CIDA, the CEA, and the heads of the major recipient bodies in the partner country. CIDA staff note that the overall decision-maker, however, is

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<sup>6</sup> Extractive Industries Transparency Initiative: <http://eitransparency.org/>

the partner country's Minister of Energy (or Minister of Hydrocarbons). The CIDA programme document (CIDA: 2007) notes improving the linkages between Canadian private sector firms and their counterparts overseas for the purpose of increased institutional and commercial relations as one of six programme priorities (see 2.2.2. for the full list of priorities), however, interviews with programme staff suggest that this is not a priority in practice.

Table 2. CIDA oil and gas sector allocations (as of February 2008, in US\$ 1000)

	Timeframe	USD	EnCana & PetroCanada Presence
<b>Americas Branch</b>			
Bolivia Hydrocarbon Regulatory Assistance Project	2003-2008	8 246	No
Peru Hydrocarbon Assistance Project	2003-2008	8 746	No
ARPEL Environmental Project (regional)	2000-2007	3 800	No
<i>Argentina</i>		342	No
<i>Chile</i>		342	No
<i>Cuba</i>		342	No
<i>Colombia</i>		304	No
<i>Peru</i>		304	No
<i>Jamaica</i>		152	No
<i>Trinidad and Tobago</i>		152	Yes
<i>Suriname</i>		76	No
<i>Brazil</i>		342	Yes
<i>Costa Rica</i>		342	No
<i>Uruguay</i>		342	No
<i>Ecuador</i>		304	No
<i>Bolivia</i>		152	No
<i>Paraguay</i>		152	No
<i>Venezuela</i>		152	Yes
OLADE Sustainable Energy Project (regional) <sup>7</sup>	2002-2008	4 798	
<b>Asia Branch</b>			
Pakistan Oil and Gas Sector Project	1999-2007	31 985	No
Bangladesh Institutional Linkage	2001-2004	400	No
<b>Central &amp; Eastern Europe Branch</b>			
Russia Legal and Management Issues in Energy Project	2000-2005	3 958	No
<b>Canadian Partnership Branch (Global)</b>			
Industrial Cooperation Division	1991-2007	13 993	-
NGOs Division - Improved Energy Sector Development	n/a	n/a	-
<b>Multilateral Programs Branch (Global)</b>			
Global Gas Flaring Reduction Partnership	2007-2010	400	-
Extractive Industries Transparency Initiative	2007-2012	1 149	-
<b>Sum total</b>		<b>77 500</b>	

Sources: CIDA, EnCana and PetroCanada

<sup>7</sup> Divided roughly equally between Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Guyana, Paraguay, Peru, Suriname, Uruguay and Venezuela.

### 2.2.2 The institutional focus of CIDA programming in oil and gas sectors

CIDA has six overarching programming priorities in the oil and gas sectors, of which one specifically relates to “[D]eveloping and strengthening the capacity of institutions and organisations charged with the responsibility of regulating oil and gas industries and implementing reforms in developing countries”.<sup>8</sup> CIDA’s assistance here focuses on providing management and technical support, particularly to new, recently created, national and regional organisations and institutions. The five other priorities focus on developing legal, fiscal and regulatory frameworks, promoting access to energy, increasing knowledge on energy and environmental issues, promoting the participation of indigenous and local communities, and strengthening institutional and commercial linkages between Canada and developing countries. Some of these latter five priorities include elements of capacity development, though not all do.

As with Norad’s Oil for Development programme, most CIDA activities aim at enhancing government and civil service capacity to create an enabling environment for the oil and gas sectors. The preferred *modus operandi* is long-term placement of (primarily Canadian) advisors in key institutions, such as the Ministries of Energy and Environment. Other forms of support are provided, including the financing of academic training for officials from key sector institutions. A number of analyses are conducted at the approval stage of specific projects, including social, economic and political analyses,<sup>9</sup> an environmental analysis or assessment, a gender analysis, a capacity analysis, and an analysis of the benefits to the recipient country. These are, however, standardised analyses, conducted across all types of CIDA projects and are not specific to its oil-focused support.

### 2.2.3 Anti-corruption activities in CIDA programming in oil and gas sectors

Corruption is mainly addressed through promotion of best practices in corporate social responsibility, for example via the ARPEL Governance Project.<sup>10</sup> CIDA has developed a programming strategy for corporate social responsibility in the extractive sectors in the Andean region of South America. The strategy includes increasing resource governance capacity and transparency, increasing dialogue and participation of stakeholders in oil and gas development and community-driven development projects. An emphasis is placed on establishing fair, transparent and credible systems for oil regulation which avoid conflicts of interest. There is recognition within CIDA that this does not adequately address corruption issues related to oil and gas. As with Norad, CIDA analysis conducted prior to project implementation follows the standard procedures outlined above. No specific corruption risk assessments are conducted prior to approval, though the standard social, economic and political analyses conducted do include a review of the political and decision-making systems and structures likely to influence or pose risks to the project.

## 2.3 USAID oil projects – making the energy sector work well

The United States provide capacity development support related to oil through a number of institutions, including the Department of Energy, the Environmental Protection Agency, the Trade and

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<sup>8</sup> CIDA, *Current CIDA Programming in the Oil and Gas Sector in Developing Countries*, March 2007

<sup>9</sup> These include, for example, analysis of the country’s (region’s) macro-economic situation and economic contribution of the proposed sector(s) of involvement; and analysis of the political and decision-making systems and structures at the national and local levels and their likely influence on (or risk to) the initiative.

<sup>10</sup> ARPEL Governance Project: <http://www.arpel.org/en/>

Development Agency, and USAID. The following section focuses on USAID oil-related projects within its 'Making the Energy Sector Work Well' category.

### 2.3.1 Allocations and organisation of USAID oil projects

USAID's total annual budget for energy sector support is approximately US\$100 million, including support to the oil, gas and electricity sectors. Of this, around US\$3 million per year is currently earmarked for oil-related projects, some of which involve capacity development. Projects with oil capacity development components are shown in Table 3. It should be noted that this list is probably not comprehensive and that information on actual allocations could not be obtained. USAID staff state that all projects may not be adequately recorded, partly because of the independence of its country Mission Directors, and partly because of substantial overlaps between US oil initiatives. The right-most column of Table 3 indicates countries where US oil companies ExxonMobil or Chevron, have a presence.

*Table 3. Non-exhaustive list of USAID oil related projects (as of February 2008)*

	Timeframe	ExxonMobil & Chevron Presence
<b>Country Projects</b>		
Angola - Energy Sector Needs Assessment	2003	Yes
Brazil - Energy, Education and Participation	2002-2003	Yes
Mexico - Decentralisation Sustainable Energy Programmes	2003	Yes
Nicaragua - Best Practices in Targeting Energy Subsidies	2003	No
Nigeria - Energy Training Programme	2002-2003	Yes
<b>Regional Projects</b>		
<b>Africa</b>		
Building Literacy in Energy Economics	2003-2005	-
Partnering with Business Project	1999-2004	-
<b>Global Projects</b>		
Energy Market Development for Economic Growth	2004-2009	-
Global Regulatory Network Programme	2002-2007	-
Nexus Between Energy and Democracy/Governance	2003	-
Public Understanding/Participation	2001-2004	-
USAID-United States Energy Association Energy Partnership Programme	2003	-

*Sources: USAID, ExxonMobil, Chevron*

To the extent that Table 3 represents an accurate picture of USAID's oil capacity development projects, the focus of country support appears to be Angola, Brazil, Mexico, Nicaragua and Nigeria. A number of regional initiatives are also supported, including the establishment of a 'Local Educational Partner' in Ghana aimed at developing West African professional capacity in the energy sector. Finally, five global initiatives address capacity development in oil to some extent in their programmes.

USAID oil-related projects are essentially decentralised, with support agreed upon and provided mainly through its country offices. Decisions regarding broad allocations are made as part of normal USAID bilateral programming. However, as noted above, Mission Directors have considerable

influence in determining the scope and priorities of particular projects. In some cases, high-level political or executive decisions in the US lead to the establishment of initiatives that lead to USAID involvement in capacity development. An example of this is former President Clinton's Caspian Basin Energy Initiative, which sought to develop a strategic energy framework in the region to advance America's energy security interests, including the creation and advancement of commercial opportunities for US companies.<sup>11</sup>

### 2.3.2 The institutional focus of USAID oil projects

USAID's overall Energy Mission focuses on two main themes: Energy Market Development, including establishing policy, legal and regulatory regimes that are attractive to private sector investment; and Energy Enterprise Development, including a focus on improving resource management capacity and local economic competitiveness in the energy sector. In terms of oil-related capacity building, it engages in a broad range of activities, including those focused on improving macro-economic impact, enhancing resource extraction, enhancing accountability and enhancing private sector development in the oil sector. According to USAID, there is no comprehensive approach as to which themes should be addressed - this is done on a project-by-project basis.

Project partners include governments, NGOs, private sector entrepreneurs and financial institutions. For the larger, in-country projects, USAID usually identifies one institution to be responsible for coordination. This may be the Ministry of Energy, the Ministry of Finance, or the local Environmental Protection Agency. The preferred approach is to rely on softer, 'people-oriented' support, where advisors are placed on long-term assignments in local institutions. Advisors may be either US or third country nationals, though there is a requirement that US firms, or US subsidiaries of international firms, must be hired as implementing agencies. Prior to implementation, a standard range of analyses is conducted, focusing on political, economic and environmental factors. These include an assessment of the economic sustainability of the project. There is some awareness on the part of programme staff of 'resource curse' issues and their relevance for projects. When questioned, USAID staff cited the work of Professor Harberger, their Chief Economist, who has worked on Dutch Disease since 1980.<sup>12</sup>

### 2.3.3 Anti-corruption activities in USAID oil projects

USAID acknowledges the relationship between technical energy sector reform and broad democratic governance initiatives.<sup>13</sup> It also states that one should not be postponed pending the other, implying that it may engage in projects where democratic governance is weak, and where, presumably, corruption is present. As a rule, however, no specific corruption analyses are conducted prior to implementation of oil-related projects.

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<sup>11</sup> US White House Press Briefing, November 1999, <http://clinton4.nara.gov/WH/New/Europe-9911/briefings/1999-11-18a.html>

<sup>12</sup> See section 4.1.1. for an explanation of Dutch Disease.

<sup>13</sup> USAID, *The Nexus Between Energy Sector Reform and Democracy & Governance*, March 2005.

### 3 Aid allocation and donor integrity

The effectiveness of aid or policy advice will depend on the integrity of those offering assistance, whether real or perceived. The Wolfowitz affair underscored the importance of donor integrity for development efforts. When news broke that the former World Bank president had secured a large pay rise for his girlfriend, World Bank country managers were reportedly laughed at when raising governance issues in partner countries.<sup>14</sup> Real integrity is important in ensuring that decisions and activities reflect what ought to be the underlying objectives of development assistance, such as poverty reduction or combating the resource curse, rather than pursuing some ulterior motive. Perceived integrity, or lack thereof, may affect implementation by partner country governments, since questions may be raised as to whether suggested policies are really in the interest of the partner country, or designed to further the ends of the donor country.

The issue of donor integrity is particularly relevant for petroleum-related aid. Petroleum-related aid is typically offered by donor countries that have a history of producing oil. On the one hand, this means that they have competence that may be of relevance to oil rich developing countries. On the other hand, they also typically have an oil industry, which is often dominant enough to exert considerable political influence in the donor country, and which can have commercial interests in petroleum-rich developing countries. Allegations can therefore be made, and have been made, that petroleum-related aid is provided or designed to further commercial ends of donor countries.<sup>15</sup> Moreover, oil is of geopolitical importance, given its central position as a source of energy, which poses the risk that petroleum-related aid may be influenced by strategic energy concerns in donor countries.

Corruption is unlikely to be effectively fought by advancing a double standard. If petroleum-related aid is to have a role in this respect, care must therefore be taken that it is allocated and designed according to the needs and interests of developing countries. This raises at least two important questions. The first is what actually determines allocations of petroleum-related aid across developing countries. Is it recipient needs, or donor commercial or political interests? The second question is how the system that allocates aid should be designed to prevent the reality or perception of allocation according to donor interests. The following two subsections address these questions in turn.

#### 3.1 Do donor commercial or political interests drive petroleum-related aid?

As a backdrop for discussing determinants of petroleum-related aid allocations, it is instructive to consider the literature on donor motivations for aid in general. Three types of motivation are commonly thought to underlie aid. First, donors may be altruistically motivated, and allocate aid according to recipient country needs. Second, donors may be more self-interested in the sense that they want to further their commercial interests abroad. And, third, donors may in self-interest advance their political objectives through aid.

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<sup>14</sup> *Scandal threatens World Bank's role*, FT.com, 22 April, 2007:  
<http://www.ft.com/cms/s/0/7c2481a8-f0f3-11db-838b-000b5df10621.html>

<sup>15</sup> *Norway's mission to save poorer nations from 'oil curse' fails to win wide praise*, FT.com, 12 May, 2006:  
[http://search.ft.com/ftArticle?queryText=oil+curse&y=9&aje=true&nclick\\_check=1&x=12&id=060512000548&ct=0](http://search.ft.com/ftArticle?queryText=oil+curse&y=9&aje=true&nclick_check=1&x=12&id=060512000548&ct=0)



There is an extensive empirical literature which attempts to identify the importance of each motive for the allocation of aid across recipient countries (cf. Berthélemy, 2006). In other words, is the amount of aid allocated to a country determined by the country's needs, and/or by donor countries' commercial or political interests in it. To measure needs, these studies typically use data on income per capita or poverty in recipient countries. Sometimes they also include the level of institutional development to capture the idea that donors are also interested in aid effectiveness. Donor commercial interests are captured by the extent of their trade or investment in recipient countries. And political interests have been proxied in different ways, for instance by colonial ties or the extent to which a recipient country has a voting pattern in the U.N. similar to that of the donor.

The results from empirical studies suggest that all three types of motives may matter for aid allocations (Alesina and Dollar, 2000; Berthélemy, 2006). Poor countries and countries with better institutions get more aid. However, countries with which donors have closer commercial ties, e.g. more trade, receive more aid, so commercial motives also matter. Finally, aid flows from donor countries to recipients are significantly related to past colonial ties, or political alliance, so political or strategic interests also appear to matter. There is variation across donor countries as to how strongly each motive matters, however. Donors like Switzerland, Austria and the Nordic countries are more altruistic, whereas commercial interests more heavily influence the aid allocations of countries such as Australia, France, Italy, Japan and the United States (Berthélemy, 2006). It is also likely that political interests have become more important for aid policy, given the trend to integrate aid agencies in foreign ministries.

Do commercial or political interests of donors similarly influence the allocation of petroleum-related aid? As argued above, given the industrial structure of the donors in question and the geopolitical importance of oil, this is a highly pertinent question to ask. Currently, however, there are no systematic studies of the determinants of petroleum-related aid allocations that we are aware of. And it is hard to draw firm conclusions from a cursory inspection of the data on allocations presented in section 2. For instance, there does not appear to be a close connection between the countries the Norwegian Oil for Development programme gives aid to, and the commercial presence of the dominant Norwegian oil company StatoilHydro. However, one cannot thereby conclude that commercial interests play no part in Norwegian petroleum-related aid allocations, as some countries might be prospective markets for the oil industry, and one also has to control for additional factors such as the institutional level of recipient countries. Nor is the data on country allocations anything more than suggestive in terms of political motives. The Norwegian petroleum-related aid to Afghanistan appears hard to understand as anything else than politically motivated, but the extent to which this is a more general pattern is hard to assess.

Our interviews with staff at the agencies providing petroleum-related aid suggest that the importance of commercial motives differs among donors. While commercial interests are played down by the Norwegian programme (which has a set of guidelines for cooperation with the petroleum industry),<sup>16</sup> USAID requires US firms to be hired as implementing agencies, while CIDA also frequently uses Canadian firms as executing agencies. Foreign policy objectives seem to play a role in aid allocations for both Oil for Development and USAID.

There is a need for systematic empirical studies of the determinants of petroleum-related aid allocations. This could be done in the manner of previous studies of general aid allocations. In principle, performing an econometric study which relates petroleum-related aid allocations to institutional needs, oil industry commercial interests, and political aspects, would be feasible. It is, however, beyond the scope of this paper to do so. We would therefore recommend that such an

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<sup>16</sup> Cooperation with other stakeholders, Norad: [http://www.norad.no/default.asp?V\\_ITEM\\_ID=10052](http://www.norad.no/default.asp?V_ITEM_ID=10052)

analysis be funded and conducted, as an important part of making the priorities inherent in aid allocation decisions more transparent.

### 3.2 Enhancing integrity in the allocation of petroleum-related aid

How petroleum-related aid is allocated between countries, depends on how the system of aid allocation is designed. Which interests prevail is influenced by the allocation decision procedure, the formal criteria used, and by who is involved in making the decisions. To enhance the integrity of aid allocations, the system should be designed in a way that limits the influence of donor country interests. This has implications in terms of formal procedures, organisational structure, staffing and subcontracting of expertise.

The procedure through which petroleum-related aid allocation decisions are made should be clear, and decisions should be based on explicitly specified criteria. This is not always the case. The decision-making process of the Norwegian Oil for Development programme involves both the programme management and the programme board (which consists of representatives from four ministries). The precise stages through which allocation decisions are actually made, and the relative authority of the management and board appear unclear. And the decision-making procedure for USAID projects appears particularly unclear. This raises the concern that allocations might be ad hoc or deviate from the fundamental criteria petroleum-related aid should be based on. It also makes it hard to attribute responsibility for the decisions made. There seems to be room for considerable improvement in this area.

Positions in bilateral petroleum-related aid programmes should not exclusively, or even primarily, be given to nationals of the donor country in question, nor should key positions be occupied by people with strong political or commercial ties. It is unfortunate that many of these programmes are predominantly staffed with donor country nationals, rather than drawing from and representing a larger pool of competence and perspectives. The programme boards are crucial in this respect, and a relatively independent board with broad international representation would do much to enhance the integrity of these programmes. In the case of the Norwegian Oil for Development programme, the board is chaired by a representative of the Foreign Ministry, which increases the risk that decisions are influenced by political considerations.

Similarly, the management of the programme should be recruited internationally, and preferably not have a background from the oil industry, which should also be the case for most of the programme staff. Where use is made of oil industry competence in particular projects, which is sometimes the case, one should take care to not simply enlist companies from the donor country, but look more widely for relevant company competence. Interviews with Oil for Development staff revealed some awareness of this issue, but also realisation that more can be done in this respect. The other donors saw this as less of an issue, and the focus seemed to be on bringing own national expertise to bear, where comparative advantages exist.

One can pose the question of whether a bilateral petroleum-related aid programme, set up by a country with a dominant oil industry or strong political interests in oil, can ever be perceived as not being self-serving. An alternative would be to channel this type of aid through a multilateral organisation. Though multilateral aid is not necessarily insulated from donor country influence (Andersen et al 2006), this is likely to be less of a problem than with a bilateral approach. The multilateral alternative would perhaps also allow for a more concerted and better coordinated approach to development in petroleum-rich countries, and perhaps also permit a more comprehensive view of the problems that need to be addressed in these countries, which the next section of this paper highlights as important. Though multilateral channels are not without corruption-related challenges – as the Iraq Oil-for-Food programme and the Wolfowitz affair demonstrate – this appears to say more about how these channels

and programmes are managed than it does about their multilateral character per se. A multilateral approach to petroleum-related aid therefore merits further consideration.

## 4 'Resource curse' perspectives on policies to beat the curse

*"Most studies of the resource curse to date are positive. Normative prescriptions may not follow easily from these, but will be crucial to allow countries to utilize their resource wealth in economically and politically better ways"* (Torvik 2007:22).

In extractive industries like oil and gas, the revenue is disproportional to the cost of production, and there is accordingly a rent accruing to those controlling the resources. The rent represents a potential and crucial blessing for a country, but at the same time it is a source for mismanagement. Exactly how the resource rents retard economic growth or the transmission mechanisms from rent to growth, is not a clear-cut issue. There are at least four possible mechanisms through which rent may retard growth, discussed below. The policy remedies for beating the curse vary according to the mechanisms at work. Policy prescriptions are therefore not obvious as indicated by the above quote from Torvik.<sup>17</sup> As shown below, however, some explanations and policies are more robust than others in explaining the curse, which we argue should inform petroleum-related aid.

In the following section, we first provide a short overview of the four main explanations of the 'resource curse': Dutch Disease, rent-seeking, patronage, and the destruction of institutions. We then proceed with summarising the empirical evidence supporting these explanations. Against this backdrop, we discuss policy implications. Finally, we will analyse to what extent petroleum-related aid programmes take these policy implications into account.

### 4.1 The four 'resource curse' perspectives

#### 4.1.1 Dutch Disease

*Dutch Disease* refers to a situation where an increase in commodity prices (such as oil prices) increases real wages and appreciates the real exchange rate which in turn lowers competitiveness and production of the non-resource exports sector. If learning and productivity changes mainly take place in this sector, or there are externalities of these activities, long-term economic growth might be harmed (Van Wijnbergen, 1984; Sachs and Warner, 1995, 1999, 2001; Torvik, 2001, Matsuyama, 1992).

#### 4.1.2 Rent-seeking

According to the rent-seeking perspective on the 'resource curse', the new income opportunities following from natural resource rents leads to *rent-seeking*. Rent-seeking can be defined as the socially costly pursuit of rents (Svensson 2005:21), and some forms (but not all) of rent-seeking qualify as corruption. One mechanism in which increasing rent from natural resources can harm growth is that entrepreneurs use their talents to undertake rent-seeking activities rather than running modern firms, leading to a fall in production (Torvik, 2002). In resource-rich economies, skilled agents can benefit more from becoming, for instance, oil bureaucrats or lobbyists, than from starting a business in another field. Since this entails the redistribution of an existing cake (that might even perish), rather

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<sup>17</sup> See also Stevens and Dietsche (2008:57)

than an expansion of the cake, this is socially costly. Mehlum et al. (2006) argue that this cost is higher in countries lacking good institutions.

Rent-seeking activities thus reduce the net increase in income for a society. The more agents are involved in rent-seeking activities, the less the income increases. The focus here is on how rents provide misaligned incentives towards the entrepreneur and, in some cases, even harm economic growth. The main problem with this type of rent-seeking is not the fight for rents in itself, but the fact that the resources (skills, time, and energy) that people expend to acquire a larger share of the rents, have alternative uses. In many resource-rich countries, the competition for rent has fuelled war (Le Billon 2001). Collier and Hoeffler (2004) find that resource abundance causes conflict: greater resource rents make fighting more likely due to the available financing, as well as more profitable, since the 'winner's' take is larger.

#### 4.1.3 Patronage

Another set of perspectives on the 'resource curse' is *patronage*. Patronage is defined as the use of public resources to secure political power.<sup>18</sup> When politicians exploit their political positions for their own gains, patronage is one form of corruption. As in rent-seeking models, agents are faced with misaligned incentives, but here the focus is on political incentives – not on incentives facing entrepreneurs. Similarly to the rent-seeking literature, these perspectives focus on how these political incentives influence economic growth. The basic problem here is that increased natural resource rents offer governments both more opportunities and greater incentives to pay off political supporters to stay in power.

Robinson et al. (2006) show how politicians discount the future by the probability of their remaining in power leading to a shorter and inefficient time horizon for government planning. With increasing resources, the future utility of having political power will increase, and as a result, politicians will change policy so that the probability they remain in power increases. To do so, they can, for instance, employ people in the public sector in order to get political support. In addition to public sector employment, politicians may invest in projects that have political but not economic payoffs (Robinson and Torvik; 2005).

Both types of activities lead both to an increase in public expenditures and to inefficiency in their use, and these activities influence the structure and composition of the public budget. For public officials, certain public investments have a higher rent-appropriation potential than other public expenditures. As these investments are inefficient, this hampers economic growth. These (unproductive) investments are more difficult to undertake in countries where government bodies are accountable to its citizens. Public investments are therefore generally higher in countries where governance or checks on political behaviour are weak (Keefer and Knack, 2007).

#### 4.1.4 Destruction of institutions

Finally, resources may harm *institutions* which in turn impede economic growth (Acemoglu et al 2005). Karl (1997) argues, for instance, that rent moulds the social and political institutions of a country into a 'rentier' state. That institutions might be influenced by the access of resources is analysed in more detail in Ross (2001a). Ross shows that in several South-East-Asian countries, timber booms resulted in politicians purposely destroying institutions in order to acquire rent. Ross (2001b) also shows that access to resources undermines democracy. As we have already discussed,

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<sup>18</sup> U4 corruption glossary: <http://www.u4.no/document/glossary.cfm#patronage>

access to natural resources provides room for patronage which may, in turn, lead to less electoral competition, scrutiny, and prosecution and, therefore, undermines democracy (Collier and Hoeffler 2005).

## 4.2 Empirical evidence: institutions play the key role

A test of the relative importance of the various channels of the ‘resource curse’ is provided in Collier and Goderis (2007). Here, we highlight four main findings from their study.

1. Dutch Disease effects, on average, explain only around 11% of the ‘resource curse’ effect. Surprisingly, it was also found that this impact was independent of governance, indicating that corruption plays a minor role within a Dutch Disease framework.
2. The curse is not explained by deteriorating governance. That resources destroy institutions is not the key for understanding the ‘resource curse’.
3. Even though the curse does not work through governance, there is strong evidence that it works *conditional* on governance. Countries having good institutions are generally more able to deal with ‘resource curse’ problems than countries with weak institutions. This underscores the importance promoting good institutions (including institutions countering corruption) plays in beating the curse. These findings are also in line with the theories focusing on misaligned political and entrepreneurial incentives presented above, particularly the contributions by Mehlum et al (2006) and Robinson et al. (2006).
4. Resource-rich countries tend to have high public and private consumption and low or inefficient investments. These findings are consistent with the patronage theory that points at inefficient redistribution in return for political support as the root of the curse (Robinson et al, 2006).

The empirical evidence provides *support for the theories of rent-seeking and patronage* discussed in sections 4.1.2 and 4.1.3. According to these theories, the key approach to lift the ‘resource curse’ is to design institutions or rules that reduce incentives for rent-seeking and patronage. This provides general implications as to what types of institutional development should constitute the main thrust of petroleum-related aid in developing countries. As we point out below, more work is needed to identify crucial institutions at a greater level of detail, and on how to induce change in these institutions, including the appropriate role of donor agencies.

## 4.3 Which institutions matter and what are their policy implications?

According to the rent-seeking perspective, the resource curse only applies in countries with ‘grabber-friendly institutions’, but not in countries with ‘producer-friendly institutions’ (Mehlum et al, 2006).<sup>19</sup> One policy remedy to beat the curse following from the rent-seeking approach is to make the return from private sector production higher, thus inducing fewer entrepreneurs to become rent-seekers. Institutions in the form of rules and procedures to stimulate private sector development are key in this respect. If possible, efficiently investing the windfall gain domestically in education and the development of a local industry might also reduce the problem.

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<sup>19</sup> Mehlum et al (2006) define ‘producer friendly institutions’ as those in which rent-seeking and production are complementary activities. Conversely, ‘grabber friendly institutions’ are those where rent-seeking and production are competing activities.

From a patronage perspective, the critical institutions to beat the curse are institutions that govern the allocation of public resources. Recall that the basic problem here is that increased natural resource rents offer governments both more opportunities and greater incentives to pay off political supporters to stay in power. In other words, what matters here are institutions through which a politician is held accountable for the use of public resources, i.e. institutions that constrain his/her ability to secure political power and enrich himself/herself through public funds.

A range of institutions thus matter if a society is to benefit from petroleum resources. These include institutions promoting private sector efficiency and institutions promoting public sector accountability. The first set of institutions restricts the possibilities of private capture, while the second set of institutions restricts the possibilities of capture by government officials. The existing focus on capacity building, horizontal accountability, technical assistance and macro-economic management prevalent in donor support to resource-rich countries is unlikely to create the required institutional change. Institutions are likely not to be changed through capacity building, particularly in the absence of vertical or societal accountability. The lack of emphasis on vertical and societal accountability (only a minor part of the support is to civil society, the free press and control organs like parliaments or the political opposition) is thus impeding institutional change.

Improving the institutional environment is not necessarily easy, and it is particularly difficult where key players benefit from dysfunctional institutions and donors lack information about the political and economic context of the country they are working in. It is unlikely that corrupt government officials would support or implement reforms that significantly reduce their take. Institutions are long-lived and hard to change. In one sense, it may be easier to improve institutions for the private sector to reduce rent-seeking, as this would make outside options more attractive for those currently involved in rent-seeking. In other words, institutions for the private sector amount to a carrot whereas institutions of democratic accountability amount to a stick. So far, however, there is little to suggest that private sector development is given much emphasis in petroleum-related aid.

Although we know at an aggregate level that the focus of domestic and international policy towards resource-rich countries should be on improving institutions, and in other ways reducing opportunities and incentives for rent-seeking and patronage, we need to know more about which specific institutions at a detailed level to support. For instance, Mehlum et al. (2006) proxy the degree of grabber-friendly versus producer-friendly institutions by applying an institutional quality index based on an un-weighted average of five indices based on data from Political Risk Services: a rule of law index, a bureaucratic quality index, a corruption in government index, a risk of expropriation index, and a government repudiation of contracts index.<sup>20</sup> This composite approach does not distinguish between different categories of institutions for good and accountable handling of the resource rent. It rather uses a broad aggregate measure. This allows broad policy guidelines, but makes it difficult to provide precise and detailed policy prescriptions.

The concept of institutions should be unbundled, and some suggestions on how this should be done have been made. In order to unbundle institutions, we need to go a step back and derive higher order principles for what institutions are and how they can induce development in general – not only in

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<sup>20</sup> Composite indices have been used by other authors as well. Collier and Goderis (2007), for instance, have applied a number of different proxies for governance. The parallel market exchange rate premium, civil liberties and political rights (Freedom House), measures of political constraints, democracy, autocracy, and a combined measure of democracy and autocracy (Polity IV), checks and balances (Database of Political Institutions 2004), and the Composite International Country Risk Guide (ICRG) risk rating (Political Risk Services Group). Further information on the example of Political Risk Services can be found at: <http://www.prsgroup.com/>

resource-rich countries.<sup>21</sup> In line with North (1981), Acemoglu and Johnson (2005) distinguish between two general types of institutions: "property rights institutions," which protect citizens against expropriation by the government and powerful elites, and "contracting institutions," which enable private contracts between citizens (reduce transaction costs in enforcing contracts). Contracting institutions regulate contracts between private agents, while property rights institutions regulate the relationship between the state or the politicians and the private citizens. Property rights institutions refer explicitly to state society relations and refer to rules that protect citizens against the power of the government and the elites. The predictability and constraints on the legislature and the executives, and private property protection are key elements of these rules. Good institutions will simultaneously support private contracts and provide checks against expropriation by the government and powerful elites. There are overlaps between the two sets of institutions, and the above referred perspective on unbundling is not clear. For instance, property rights institutions are also important for securing contracts between individuals.<sup>22</sup>

Even though we may be able to unbundle the concept of good institutions, this unbundling does not necessarily map-out into unique institutions or policy packages (Rodrik, 2004). Institutions that work well in Norway, or in another developed country, do not necessarily work well in another social and political context (see Stevens and Dietsche, 2008). We need to analyse country-specific policies. It might even be counter-productive to, for instance, initiate a petroleum fund in a low income country in desperate need of public investment for poverty reduction. Experiences from other countries at a similar development stage might be more valuable for a developing country than the experience from donors like the US, Norway or Canada.<sup>23</sup> Second, there might be alternative institutions that fit better to local institutions and are more efficient. Finally, even if we have identified relevant institutions, these institutions are hard to change due to (colonial) history, social cohesion or political and economic vested interests (see Stevens and Dietsche, 2008). Without an analysis of these constraints one is unlikely to make a difference.

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<sup>21</sup> Institutions refer to the social, economic, legal and political way that a society is organised. More specifically it refers to the rules of the game within which both politics and markets operate and these rules, in turn, determine economic performance (Dahlgard and Olsson 2008).

<sup>22</sup> Although there are overlaps between the two sets of institutions, there are also significant differences. When property rights institutions fail to constrain those in power, there is no possibility to prevent future expropriation as the state is the ultimate arbiter of contracts (Acemoglu and Johnson (2005: 951). Institutions are then extractive as in Acemoglu et al (2002).

<sup>23</sup> Successful experiences are, however, hard to find. Botswana is often cited as a positive example of natural resource management, though not in relation to oil.



## 5 Petroleum-related aid and corruption

As the previous section indicates, corruption (in the form of rent-seeking or patronage) is an important reason why oil-rich countries perform badly in socio-economic terms. Addressing the forms of corruption that underlie this resource curse should, therefore, be a priority. There are also good reasons for addressing corruption more generally in oil-rich countries, due to the basic dysfunctions and injustices generated.<sup>24</sup> Many of the corruption issues faced by oil-rich countries are the same as those of other developing countries, but their incidence and impact may be heightened by the presence of large resource rents. In addition to these general issues, oil-rich countries also face specific corruption-related challenges, such as the question of how to design a corruption resistant system for awarding resource concessions.

The information we have collected on petroleum-related aid programmes suggests that a main problem is their general approach to corruption, more so than fine-tuning on narrow technical issues such as resource concessions. This section therefore draws important overarching perspectives and lessons from the corruption literature with concrete implications for how petroleum-related aid programmes can better address corruption. In this, there is also a division of labour with other outputs from the U4 Anti-Corruption Resource Centre. For more information on oil regulation and grand corruption, see e.g. Al-Kasim et al (2008). Kolstad and Søreide (2008) also discuss some specific corruption-related challenges in resource-rich countries.

To structure and inform the discussion, the following sub-section discusses alternative approaches for addressing corruption, and very briefly summarises key insights from the corruption literature. This is then used as a backdrop for a set of recommendations that aims at making petroleum-related aid programmes more effective and relevant in addressing corruption.

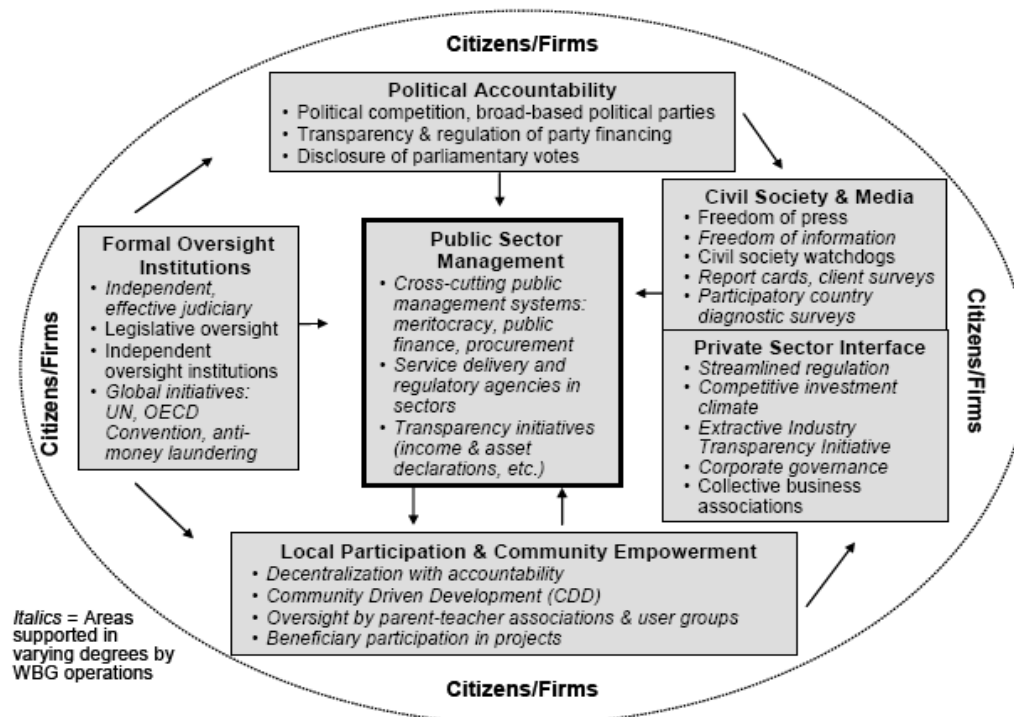
### 5.1 Donors and corruption: the state of the art

Donors have used a variety of approaches to address corruption in partner countries. Most of these approaches have centred on improving governance through increased accountability of public officials. The variety of approaches used, or opportunities available, can be illustrated by means of the below figure of World Bank entry points for governance reform. The various entry points can largely be categorised on three different vectors of accountability: vertical accountability of political leaders to citizens through electoral channels (top box of Figure 1), horizontal accountability where some government agencies oversee, control, redress and sanction other government agencies (left-most and centre boxes), and, finally, societal accountability, where civil society and the media monitor and address actions of the state (bottom and right-most boxes).

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<sup>24</sup> See Kolstad (2008) for a discussion of donors' ethical duties in relation to corruption.

Figure 1: World Bank entry points for governance reform



Source: World Bank (2007)

A recent report which reviews experiences from donor approaches, and relates them to the corruption literature, makes the following main points:<sup>25</sup>

Donor-supported anti-corruption efforts in developing countries have focused on creating and improving institutions of horizontal accountability, such as anti-corruption commissions, audit institutions etc. The impact of these interventions on corruption has been disappointing. As a result, donors have taken more interest in vertical and societal accountability measures, such as democratisation, or the strengthening of civil society or the media. From the corruption literature, it emerges that each of these approaches is likely to be effective only under certain conditions. For instance, the effectiveness of civil society in addressing corruption depends on its capacity to acquire, process and act on information of government misconduct, and their inclination to act, which depends on the type of misconduct uncovered and the extent to which civil society is dependent on the government. This implies that the most effective approach depends on partner country conditions.

An important reason why donor anti-corruption efforts have been ineffective has been the unwillingness of corrupt governments to wholeheartedly implement reform. Anti-corruption efforts have been too focused on reforming formal institutions, and too little attention has been paid to the political economy of reform. Elites typically only support reform processes that do not undermine their ability to retain power and will instrumentalise reform processes that do not serve this purpose. An example of the latter is privatisation processes, which have frequently been misused for private enrichment by government officials. This points to the need for anti-corruption efforts to be based on thorough analyses of the political economy of partner countries, in order to understand the interests

<sup>25</sup> See Kolstad et al (2008) for details.

and incentives of key players. Moreover, these perspectives highlight that anti-corruption work is inherently political, and cannot therefore be addressed through technical approaches alone.

There is also a need to look beyond the relatively narrow governance agenda that has been advanced to reduce corruption. As discussed in the previous section, decisions about whether to engage in rent-seeking/corruption or in productive activities (such as starting a business) are influenced by their relative profitability. An implication is that effective anti-corruption efforts may be less about governance and more about private sector development. In other words, the traditional donor focus on corruption as a problem of accountability and poor governance may be too limited. The supply side of corruption has also been neglected, and more emphasis should be placed on reducing the attractiveness for private agents, in particular multinational corporations, of offering bribes.

## 5.2 How should petroleum-related aid programmes address corruption?

On the basis of this very brief summary of current thinking on corruption and the role of donors, some key implications can be drawn about how petroleum-related aid programmes can better address corruption in oil-rich countries. This suggests a number of changes to the current focus, priorities and design of these programmes. In particular:

- *Anti-corruption efforts should be integrated within the core activities of petroleum-related aid programmes.*

A problem in these programmes is that the main activities often centre on providing technical advice on macro-economic, resource or environmental management issues. To the extent that governance or anti-corruption are pursued, these types of activities have more of an add-on nature. Given the centrality of the problem of corruption in oil-rich developing countries, this is unsatisfactory. A standard line of defence is that macro-economic, resource or environmental management has implications for corruption, but as the previous subsection argues, one cannot simply assume that technical interventions will have a beneficial effect. A largely technical approach amounts to a form of voodoo anti-corruption strategy.

- *Petroleum-related aid programmes should expand their anti-corruption toolkit. Some of the programmes have a relatively narrow anti-corruption approach, focusing for instance on civil society.*

The effectiveness of such an approach depends on a number of conditions, and one cannot simply assume that it will be effective in all countries. More generally, the 'rentier' state perspective suggests that a key problem in resource-rich countries is the absence of independent groups that hold a government to account. A major challenge is therefore to support the formation of alternative power bases in oil-rich countries. Besides civil society, this may require support to parliamentarians, the media or other players or processes that may counterbalance the power of the government.

- *Anti-corruption strategies should focus on what is likely to work in a given country context. This means that the assumptions necessary for any single intervention to work should be assessed.*

For instance, for the civil society approach, there is a need to check whether organisations exist that are relatively independent of the government, and that have the capacity or inclination to forcefully and credibly address the issue of corruption. Often, there will be a need to combine approaches. Civil society may, for instance, be more effective given a functioning media, and vice versa.

- *Petroleum-related aid programmes need to invest more in understanding the political economy of recipient countries.*

There is a risk that self-serving governments will undermine reform that would be in the interests of the population. One should therefore analyse the risk that reform will be undermined, and the possibilities for building a coalition behind reform. There is also a possibility that seemingly beneficial reform will be taken advantage of, or serve to reinforce power imbalances in a society. For instance, policy advice that increases government control over oil resources need not have a beneficial effect. A non-benevolent government may simply pocket more of the resource rents, and be less accountable due to its strengthened financial position relative to other groups. Or increased control over oil resources may make staying in power more attractive, resulting in more patronage to influence the government's chance of re-election. This makes it essential to analyse the interests and incentives of key players, and also to examine cultural traits like the extent and nature of clientelism in a society. It also means that basing donor interventions on government demands may not always be the most effective way of promoting development in oil-rich countries.

- *Donors should invest more in understanding what works in reducing corruption in oil-rich countries.*

More research needs to be conducted into the particularities of corruption in a resource-rich context, to complement the more general literature on corruption that presently exists. Petroleum-related aid programmes should also explore other ways of transferring knowledge than the initial North-to-South model. Since industrialised economies started extracting oil at a time when institutions were fairly advanced and corruption low, their histories may contain few lessons on how to deal with corruption. An alternative approach is to transfer knowledge between oil-rich developing countries.

- *Addressing the supply side of corruption is crucial in oil-rich countries.*

There are numerous examples of how multinational companies, but also wealthy domestic interests, have exploited weak governments in oil-rich countries (see e.g. Shaxson, 2007). To curb this kind of behaviour, corruption needs to be made more costly to corporations. However, addressing the private side of corruption is something that may require measures at a higher political level in donor countries. There may still be a role for petroleum-related aid programmes here, in helping to make sure that information on corporate activities in oil-rich developing countries is forthcoming.

## 6 Conclusion

This analysis of petroleum-related aid activities has sought to contrast current donor policy with theory and evidence on the resource curse and on corruption. While petroleum-related aid can play a constructive role in oil-rich countries, and governance issues are beginning to receive more attention in these types of programmes, there is cause to be critical of the way in which this form of aid is provided. First, petroleum-related aid is given by countries with strong commercial and political interests in the oil sector, raising questions about the integrity and credibility of these types of programmes. Second, the priorities of petroleum-related aid programmes do not really reflect the policy prescriptions of the scientific literature on the 'resource curse', which makes it unlikely that they will produce the institutional changes required to lift the curse. Third, petroleum-related aid activities of the donors studied address the issue of corruption only to a limited extent.

Limiting the influence of donor country interests in petroleum-related aid has implications for the formal procedures, organisational structure, staffing and subcontracting of expertise within this form of aid. In particular, allocation procedures should be clarified, while positions should not exclusively or even primarily be given to donor country nationals or individuals with strong commercial or political ties. Management of such aid programmes should, further, be recruited internationally and preferably not among individuals who have an oil industry background. We raise the possibility that channelling aid via multilateral programmes may be an appropriate way to disassociate petroleum aid from particular national concerns.

The existing focus on revenue, resource, and environmental management prevalent in petroleum-related aid is too narrow and sector-specific to address overarching problems of accountability and unfavourable incentives that are at the core of the 'resource curse'. Nor does capacity building and technical assistance per se induce positive institutional change. While inducing such change is not necessarily easy, and is particularly difficult where key players benefit from below-par arrangements, donors' lack of emphasis on vertical and societal modes of accountability (democratisation, support to civil society, the free press) may actually be an impediment to necessary reform. More could also be done to improve institutions for the private sector that act as an inducement to productive activities as opposed to rent-seeking, and may in the longer term create demand for domestic accountability.

Given the centrality of the problem of corruption in oil-rich developing countries, anti-corruption efforts should be integrated within the core activities of petroleum-related aid programmes. For the programmes surveyed, anti-corruption activities are either absent or narrow, and petroleum-related aid programmes should therefore expand their anti-corruption toolkit. Anti-corruption strategies should focus on what is likely to work in a given country context, which implies a need to invest more in understanding the political economy of recipient countries. Moreover, addressing the supply side of corruption is crucial in oil-rich countries.

It should be noted that more work needs to be done in analysing the implications of resource rents in oil-rich countries, and the role of petroleum-related aid. To make the priorities inherent in aid allocation decisions more transparent, econometric analysis of the motivations behind petroleum-related aid allocations should be conducted. More research also needs to be done to determine how the broad institutional implications of the 'resource curse' literature translate into more detailed institutional requirements to avert a 'resource curse'. Importantly, understanding the political economy of oil-rich countries is essential in determining the scope and means of institutional reform, and should be a critical part of further research in this area.

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## Abstract

Petroleum-related aid programmes and projects are a key part of donor activities in oil-rich developing countries. This U4 Issue explores the petroleum-related activities of three bilateral donors: Norad, CIDA and USAID. While governance issues are beginning to receive more attention in these types of programmes, they still form a minor part of programme activities. The petroleum-related aid activities of the donors in question address the issue of corruption only to a limited extent. Given the commercial and political interests of donor countries, questions about the integrity and credibility of these types of programmes can be raised. Moreover, the narrow, sector focus of these programmes makes it unlikely that they will produce the institutional changes needed to lift the 'resource curse'. The paper is part of the project 'Corruption in Natural Resource Management' at the U4 Anti-Corruption Resource Centre: [www.u4.no](http://www.u4.no)