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Transparency in oil rich economies

Ivar Kolstad and Arne Wiig, CMI

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U4 Anti-Corruption Resource Centre
Chr. Michelsen Institute
P.O. Box 6033 Postterminalen,
N-5892 Bergen, Norway
Tel: + 47 55 57 40 00
Fax: + 47 55 57 41 66
E-mail: U4@U4.no
www.U4.no

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Abstract

Corruption is a serious problem in many developing countries that are rich in oil and other natural resources. This is central in explaining why resource rich countries perform badly in terms of socio-economic development. Transparency has recently been viewed as a key factor in reducing corruption and other dysfunctions in natural resource rich countries. This paper addresses the relationship between transparency and corruption, with an emphasis on oil rich countries. It provides a systematic overview of the available literature and arguments on transparency and corruption. In particular, using the case of Angola, it focuses on some of the main corruption related problems caused by limited access to information. It also looks at the approach of current transparency initiatives, such as the Extractive Industries Transparency Initiative (EITI). The analysis of the paper aims to increase understanding of the role of transparency, thus providing a general basis for subsequent policy analysis in this area. The paper is part of the project 'Corruption in Natural Resource Management' at the U4 Anti-Corruption Resource Centre: www.U4.no

1 Introduction

Corruption is a huge problem in many developing countries that are rich in oil and other natural resources. It is central in explaining why resource rich countries perform badly in terms of socio-economic development, a phenomenon that has been termed the resource curse.[i] As of late, transparency has been viewed as a key factor in reducing corruption and other dysfunctions in natural resource rich countries. Several initiatives have therefore been taken to improve transparency in resource rich countries, such as the Extractive Industries Transparency Initiative (EITI), which focuses on transparency in revenues from extractive industries such as petroleum and minerals.

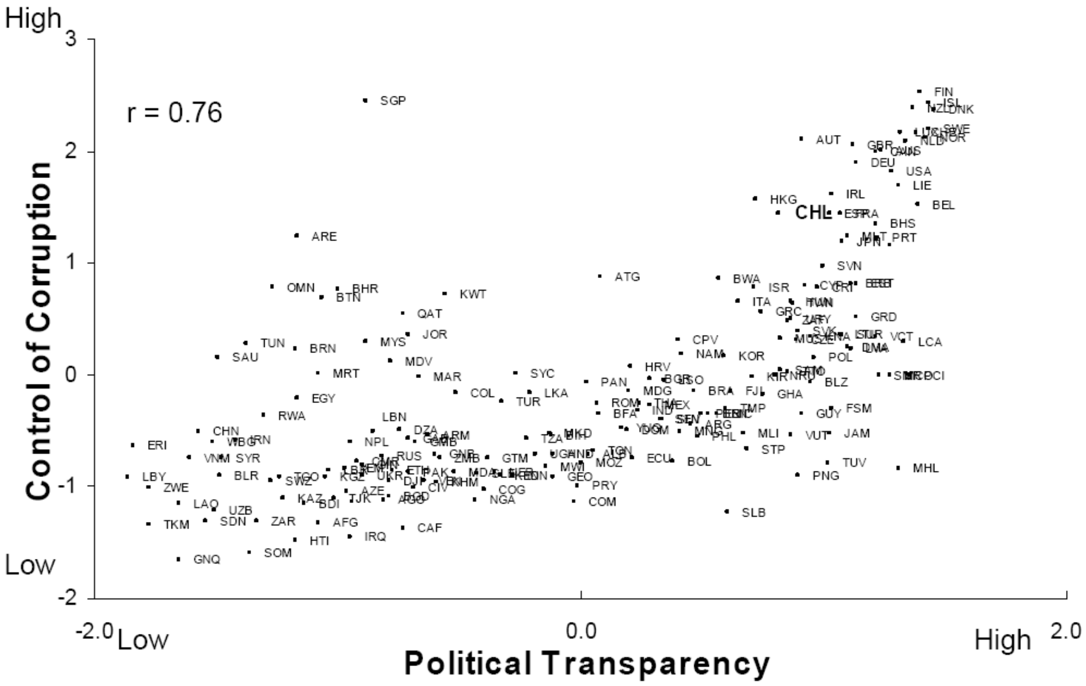
This paper addresses the relationship between transparency and corruption, with an emphasis on oil rich countries. Transparency is defined here as public access to information, or more precisely "timely and reliable economic, social and political information … accessible to all relevant stakeholders".[ii] Corruption is defined as the abuse of public office for private gain. For the purposes of this paper, the commonly used distinction between political corruption and bureaucratic corruption is helpful. Political corruption is abuse of office by those who make the rules of the game, e.g. decide on laws and regulations, and the basic allocation of resources in a society. Bureaucratic corruption takes place at the implementation end of public policies, capturing corrupt acts among those who implement the rules made by top officials.

Figure 1 depicts the scores of 190 countries in 2004, on an index of political transparency (which captures transparency in political funding, openness in political institutions, freedom of speech and freedom of the press) and on the index of control of corruption due to Kaufmann et al (2005). There is a clear positive correlation between the two, indicating that more transparent countries are less corrupt. The figure does not, however, prove that there is a causal relationship between the two, or that an association between the two remains once other determinants of corruption are controlled for. To draw these kinds of conclusions, the use of more advanced econometric methods would be required, which is beyond the scope of this paper.

This paper provides a systematic overview of the available literature and arguments on transparency and corruption, in reference to oil rich countries. It should be noted that though transparency is a politically popular concept among donors and others, there has been little formal research on what role access to information plays in improving development outcomes in resource rich economies.[iii] We therefore have to use general insights on information, corruption and development from the scientific literature, and apply these to a resource rich context.

We begin by illustrating some of the main corruption related problems caused by limited access to information, using the case of Angola (section 2). This leads to a discussion of general problems caused by an absence of transparency, and their relevance to oil rich countries (section 3). As section 4 argues, however, improved transparency is only a necessary but not sufficient condition to reduce corruption. Section 5 presents arguments that, in certain settings, transparency might actually increase corruption. For practical applications, it is important to note that transparency can mean a number of things, and that transparency initiatives differ in coverage and approach. Section 6 therefore deconstructs the concept of transparency and, in light of the preceding analysis, discusses the approach of current transparency initiatives, such as the EITI. The analysis of the paper aims to increase understanding of the role of transparency, thus providing a general basis for subsequent policy analysis in this area.

Figure 1. Political transparency and corruption



Source: Kaufmann and Bellver (2005).

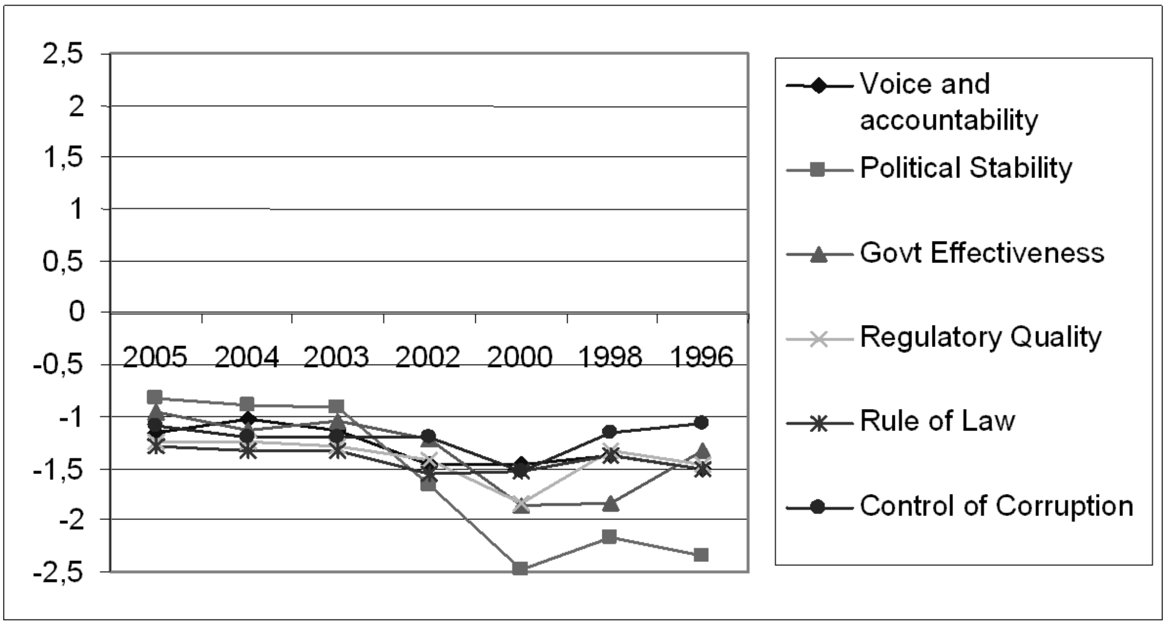
2 How a lack of transparency may corrupt: The case of Angola

The type of problems a resource rich country may face due to the non-transparency of government policies, can be illustrated using the case of Angola. Angola is the second largest oil producer in Sub-Saharan Africa. At the same time the government is highly unaccountable to the population, corruption is widespread and public decisions are not transparent. In Angola, non-transparency goes hand in hand with corruption. Lack of information makes it difficult for citizens' ability to challenge corrupt officials.

From the few indicators available, transparency is low in Angola. Notably, public budgets are non-transparent. According to the International Budget Project, Angola scores 4 percent out of a possible 100 percent on the Open Budget Index 2006 (http://www.internationalbudget.org/). The Index evaluates the quantity of information provided to citizens in the key budget documents during the course of the budget year. Angola's performance indicates that the government provides citizens with scant or no information on the central government's budget and financial activities and that there is much room for improvement. The public budget is probably the most important political instrument a government has to rule a country. In a resource rich country, public financial management is extremely important for budget disciplines and the quality of service delivery. A recent study by Isaksen et al., (2007:5) concludes that: "Our study, as well as cross-country comparisons by the International Budget Project, discern two main deficiencies in the budget process in Angola, both related to the lack of transparency: *a) The executive's budget proposal is not publicly debated and no pre-budget paper is prepared; and b) comparisons between budgeted expenditure and actual outcomes are not made and audit reports are not prepared."*

The lack of transparency in Angola corresponds to a generally poor institutional setting, and Angola scores low on political accountability. The last election took place in 1992, and the same government has ruled since then. On Kaufmann's voice and accountability measure (which provide information about citizens' ability to participate in selecting the government), Angola ranks as number 172 out of 207 countries. A similarly low score is shown by other measures. For instance, on the Polity measure of democracy (measuring the general openness of political institutions), Angola only scores two out of a maximum of ten points (http://www.cidcm.umd.edu/polity/) From various sources it is confirmed that the government is highly unaccountable to its citizens (cf. figure 2).

Figure 2. Angola scores low on Kaufmann's indicators of governance



Source: Kaufmann (2007).

Media might play a role in improving political accountability (see for instance Besley and Prat, 2006). In Angola, the opposite is rather the case. Information is controlled by the government and the country lacks press freedom.[iv] A new Press Law gives the state media monopoly for nationwide coverage. Most media are government media or controlled by the ruling party, and consequently push official lines, agendas and positions, leaving little room for criticism, analysis and opposition (Amundsen and Abreu 2006:33). Close to 30% of the population does not have access to information on a weekly basis, whether by radio, newspaper or TV, and only 3% of citizens have access to information from these three sources on a daily basis (see IRI 2003:13). Close to 66% of respondents with access to information in Luanda believe mass media will campaign in favour of the party in office (see IRI 2003:89). The ownership structure, the regulation of media and the general perceptions among citizens indicate that the media does not improve political accountability in Angola.

In a survey of potential voters in Angola undertaken by the International Republican Institute (IRI, 2003:62), respondents generally lack trust in governmental institutions.[v] Citizens lack trust in the government, the media (including journalists) and, particularly in the provinces, they lack trust even in their friends. IRI concluded: "[that] friends appeared as an institution in which no trust can be deposited may be a sign of weak social cohesion and demoralization of social capital" (IRI, 2003:59). This lack of trust adds to the challenge of reconciliation Angola is facing after nearly 30 years of civil war. The war stimulated a culture of secrecy in Angola (see Isaksen et al., 2007) making it even harder to get out of the 'secrecy trap'.

The resource rent is huge in Angola and GDP per capita was 1,322 USD in 2004, far above the average for Sub-Saharan Africa. As oil production accounts for 55% of GDP, 94% of exports and some 80% of government revenue, the sector plays a key role in the development of the Angolan economy. Nearly all the major oil companies and oil service firms are present in Angola. Led by a tremendous boom in the value of oil production, economic growth has climbed to a two-digit level and Angola is presently one of the world's fastest growing economies.

Consistent with the large available rents and the poor and un-transparent institutional environment, Angola is generally perceived to be a corrupt country. It ranks number 142 out of 163 countries on Transparency International's Corruption Perception Index (2006). It ranks as number 182 out of 203 countries on Kaufmann's Control of Corruption Index in 2005 (see Kaufmann et. al. 2007).

High growth rates in Angola represent a deviation from the typical resource curse pattern of low growth and high exports of natural resources that one normally finds in resource rich countries.[vi] At the same time, Angola has a worse income distribution than most other countries, including oil exporting countries. Almost 70% of the population live on less than 2 dollars a day and inequality is huge (the Gini index is 0.62). The majority of Angolans lack access to basic health care. Primary school enrolment is very low at 56%, and suffers from high repetition and drop out rates. The illiteracy rate is 50% in rural areas (World Bank 2006) and life expectancy at birth is 41 years.

There are no available comprehensive time series of income poverty in Angola. Data is available on some social indicators, but it is hard to identify any progress. In spite of economic growth and the end of a long civil war, life expectancy at birth has only increased 1.4 years during the period 1995-2005. This stems from a reduction in the male mortality rate. The mortality rate of adult females has increased while infant mortality has not decreased (it is even higher than in other Sub-Saharan countries).

The low development impact of oil-led growth reflects in part a low political effort to address distribution issues (Wiig and Ramalho, 2005). Reform in other areas is slow: Angola has not signed the EITI initiative and the international (donor) community lacks leverage to pressure the government to undertake a more development-friendly policy.

3 Which problems does transparency address?

According to the Universal Declaration of Human Rights, seeking and imparting information is a human right. There is common agreement that *good institutions* play a key role in avoiding the problems many resource rich countries face with their development. Transparency is considered important because it reduces the possibilities of undermining institutions (for instance through corruption) and is a prerequisite for the establishment of proper regulatory institutions and other institutions that deal with resource curse problems (see for instance Isaksen et al. 2007). Information also improves citizens' ability to challenge abuses (incl. corruption), since reliable quantitative information is more difficult for politicians and other public officials to brush aside as anecdotal, partial, or simply irrelevant.

To better understand the problems caused by a lack of transparency, it is vital that we understand how information affects the decisions of potentially corrupt agents. Though a lack of transparency causes a number of problems, this section focuses on the corruption-specific issues. The type of corruption varies across countries. One should expect that political corruption is most prevalent in resource rich countries as the political elite control a huge resource rent. As a benchmark for the analysis of political corruption, we start with a model of bureaucratic corruption. This section makes the following points:

- A lack of transparency makes corruption less risky and more attractive
- A lack of transparency makes it harder to use incentives to make public officials act cleanly
- A lack of transparency makes it hard to select the most honest and efficient people for public sector positions or as contract partners
- Informational advantages give access to rents, making reform difficult
- A lack of transparency makes cooperation more difficult to sustain, and opportunistic rent-seeking more likely
- A lack of transparency may undermine social norms and reduce trust

3.1 Transparency and the decision of a potentially corrupt agent

The following basic model of corruption provides a good starting point for analyzing the importance of information. The model is most easily presented by using the stylized example of a public official collecting tax revenue from the oil sector. We assume that the public official has two choices. He can either be honest or corrupt. If he is honest, he reports the factual costs of the oil company, and receives a fixed wage with certainty. Alternatively, he can be corrupt and receive a bribe in addition to his wage.[vii] For simplification, the bribe is a form of compensation to the bureaucrat for reporting a higher cost of the oil company, thereby reducing the company's taxes.

The bureaucrat makes the choice that gives him the highest expected utility. If he is honest, his utility is determined by his wage rate. If he is corrupt, he will receive his wage and a bribe, but there is a probability that he will get caught and be sanctioned (in the form of a fine, for example). It follows from such a model that corruption decreases when:[viii]

- the wage of the bureaucrat is increased
- the fine is increased
- the bribe is reduced
- the probability of being caught is increased
- the moral costs of getting income from bribery increases
- the bureaucrat's risk aversion increases

From such a simplified framework, it follows that the combination of a large bribe, low wages and lack of enforcement are factors that stimulate corruption.[ix] These are all factors that prevail in resource rich developing countries where there is ample space for bribes when resource rents are huge. Nigeria during the early 2000's is illustrative of the scale of corruption where these factors are present. McMillan (2005: 160-161) notes that, in 2003, the oil-services company Halliburton admitted bribing a Nigerian "[…] tax official to obtain favourable tax treatment for an oil and gas facility a Halliburton subsidiary was building. In a filing to the US Securities and Exchange Commission, Halliburton said that during 2001 and 2002 it had made "improper payments of approximately US$ 2.4 million"."

As our focus is on transparency, let us discuss this in more detail. Firstly, lack of transparency makes it difficult to know exactly how the explanatory variables referred to above influence corruption. When the relationships are unclear it also makes it more difficult to implement the right policies to reduce corruption.

Secondly, transparency has a direct impact on detection (the probability of getting caught). The more transparent the cost structure of the oil company, the more difficult it is for the bureaucrat to distort information and the easier it is to be caught if doing so. When information is sparse, it is difficult to reveal who is corrupt, or whether a bureaucrat is corrupt or not.

Thirdly, transparency might also have indirect impacts on the other explanatory factors of corruption referred to above. Transparency might, for instance, have an indirect impact on law enforcement. Under non-transparent circumstances proof is more difficult to generate and corrupt officials are able to buy their way out of punishment. Transparency might also have an impact on the bribe size. On the one side, a lack of transparency may lead to a higher bribe as corrupt officials have a greater bargaining power when information is sparse. On the other hand, lack of transparency reduces the expected costs of being corrupt and might therefore decrease the bribe the bureaucrat requires for being corrupt. We will argue later that transparency has an indirect impact on moral costs. In sum, transparency is likely to reduce corrupt behaviour.

3.2 Lack of transparency makes it difficult to provide incentives

So far, we have seen the corruption decision from the perspective of a potentially corrupt official or agent only. But the agent can be viewed as acting on behalf of an uninformed government (the principal).[x] The principal is aware that the agent can behave corruptly and would like to offer the agent a contract that gives him incentives to behave honestly.[xi]

The agent is more informed about his own actions than the principal. The agent may take bribes and the principal must design incentives that make bribes less likely. However, in line with previous arguments, the principal cannot directly observe whether the agent takes bribes. He can only observe an imperfect signal or outcome of the agent's action and can only influence the choice of the agent by giving a transfer conditioned on the observable outcome. In our example, the principal can only observe the reported costs by the agent. This cost is an imperfect indicator or signal of the agent's action. Reporting low costs indicates that the agent behaves honestly. If the agent is given a higher payment when he reports low costs, he gets incentives to behave honestly.

The more noise related to the reported cost measure, the more difficult it is to base incentives on this measure. A lack of transparency increases the bias and variance of the signal. A lack of transparency may therefore make it more difficult for the principal to induce non-corrupt behaviour through incentives. So not only is it hard to directly expose corruption in an un-transparent environment, it is also difficult to indirectly reward clean behaviour.

3.3 Lack of transparency makes it difficult to select honest bureaucrats or contract partners

When agents have different levels of integrity and the principal has imperfect information about whether an agent is honest or not, the principal faces a so-called adverse selection problem. The principal would prefer to select an honest agent to one likely to be corrupt, but does not know the type of the agent. For instance, he would prefer to hire a tax administrator who is more inclined to report the true costs of oil companies, but this trait is hard to observe.

There are generally two solutions to the problem of adverse selection. One is for honest agents to signal their type, for instance through some sort of certification mechanisms, reputation or guarantees. The alternative is that the principal designs a screening contract through which the agent's type is revealed. One would, for instance, expect that the honest bureaucrat would accept a lower fixed wage than a dishonest one as long as he gets a high bonus for reporting low costs. Providing a bonus presents a type of information rent to the agent in order to disclose their type. Different types of contract may therefore attract different types of people and the principal should seek to identify those contracts that attract honest people.[xii]

If information is scarce, there is little hard evidence that agents are of a particular type, making the adverse selection problem a salient one. Moreover, in an un-transparent environment, there are few trustworthy signals of honesty, through which honest agents can signal their integrity. It is also more difficult or costly to design and implement contracts that reveal the type of the agent. The more difficult it is to reveal whether the oil tax collector is honest or not, the more difficult it is to recruit honest tax collectors and fire dishonest collectors. Similarly, the more difficult it is to judge the cost efficiency of a contract partner, the more difficult it is to sign contracts with the most cost effective oil company.

If this is the case, the principal must base his recruitment and remuneration decisions on 'average characteristics' of the applicants. In the last instance, this may produce terms unacceptable to the most efficient agents, who drop out of the public sector or private sector relationship entirely. To the extent that transparency reduces asymmetric information about characteristics of the agent, *transparency increases the probability that one selects the 'right' type of agents* and this is particularly important in situations where their type influences efficiency. For instance, in an oil resource rich country, it is important to select the most cost-effective oil companies and government officials with the highest competence and discretion (honesty).

3.4 Information is power and rents

In the examples referred to above, the agent gains from his informational advantage. This suggests that it is in the interest of an agent to control or capture information, particularly when the gains are huge and when the cost of making information non-transparent is low (as in a country with huge natural resources, lack of an opposition and a free press). So far, the government or principal has been assumed to be benevolent, which may not be the case. The government may be as interested in capturing rents from oil, as bureaucrats in lower tiers. The government may therefore also gain by making information less transparent.

Another way to look at this is to change the principal-agent model into a framework where the voters in a resource rich country are the principal while the government is the agent and democracy is the contract between the parties. If the government does not behave according to the terms set by the voters, in principle it can be replaced through an election. For this type of vertical accountability to work, however, voters have to be informed of the actions of governments. Where information is scarce, this type of accountability does not work properly.[xiii]

The point is that information capture influences political outcome. Lack of transparency discourages public participation in democratic processes. Secrecy raises the price of information and thereby discourages voters or groups without special interests from participation. Interest groups might on the other hand lobby for their interests. If outsiders or particular groups have less information than the rulers, they may feel less confident to participate in the political process and this may impede their voice and impede political and social change. Voters use available information to decide whether to keep the current party in power or to replace it with the opposition, but if, at the time of election, they are uninformed about the consequences of current policies, they might not punish the current ruling party.

Democratic institutions play a key role in dealing with resource curse problems. Secrecy is an important way in which government officials attempt to influence public opinion or create rents for themselves. When the government controls information, it therefore gives rise to an additional adverse selection problem: It makes it less likely that voters punish bad government as bad politicians or policies are less likely to be identified and therefore replaced. Information capture also exaggerates the moral hazard problem: Elected politicians are more likely to engage in rent extraction as they know they are not likely to be caught. Conversely, transparency reduces the possibilities of rent seeking activities and increases the accountability of the government.

It follows that corrupt governments would forego huge rents if they implemented reform increasing access to information. This shows that information problems may be perpetuated where appropriable rents are large. This is related to the rentier state perspective, which suggests that resource revenues undermine democracy in several ways.[xiv] Firstly, oil revenues may reduce the need for domestic taxes, and the public is in turn less likely to demand government accountability (including access to information). Secondly, oil revenues may be spent on patronage, which similarly reduces pressure for democratization. And, thirdly, oil wealth may be used directly to oppress a population or prevent the formation of social groups independent of the state.

3.5 Information failure undermines cooperation and trust

Information is also central to facilitating and sustaining cooperative behaviour. From the corruption literature we know that if two independent agencies regulate a firm or an individual, these two may set bribes too high compared to what is optimal for them both.[xv] The reason is that, in setting bribe levels, each agency does not take into account that demanding higher bribes reduces the opportunity of the other agency to extract bribes. In other words, these types of externalities imply that what is individually optimal for each agency is not jointly optimal for the agencies. In the oil industry, oil companies commonly relate to several public sector bodies, such as the ministry of finance, the national oil company and so on, which means that this type of problem may arise.

This argument is commonly taken to imply that centralizing the tasks of the two agencies to a single agency, would reduce bribe levels and make everyone better off. However, a reduction of bribe levels would also be possible if the two agencies were able to collude in setting bribes, in other words if they were able to reach and enforce some sort of cooperative agreement. This requires information about the other agency.[xvi] If you do not know what the other agency does and how it affects you, or vice versa, it is hard to attain an agreement on how to set bribes. In an un-transparent environment, these types of cooperative agreements may thus not be realized, and the efficiency of the economy may be severely restricted.

Collusion in setting bribes may not, in general, be optimal. However, the basic argument extends to cooperative behaviour above and beyond collusion in setting bribes. It has been pointed out that windfall gains (such as aid or natural resource rents) make it more lucrative for agents to deviate from a cooperative agreement to spend revenues on public goods, in order to privately appropriate a part of the revenues.[xvii] Natural resources may thus increase rent-seeking and corruption. The existence of a cooperative agreement in the first place depends on the possibility that those deviating from it can be punished in subsequent periods. However, where information on the actions of others is imperfect, it can be harder to form or uphold these types of cooperative agreements. An absence of transparency may therefore exacerbate problems of reaching and sustaining cooperative social arrangements, intensifying the detrimental effect of natural resource rents.[xviii]

This is also related to the question of social norms. Several studies suggest that corruption feeds corruption, that the extent to which it pays to be corrupt, depends on whether others are corrupt.[xix] Where corruption is widespread, this means that corruption is also highly persistent, as small changes in the number of corrupt individuals are unlikely to make others follow suit. For purely self-interested individuals, social norms against corruption may be hard to uphold in the absence of information, since it is hard to establish mechanisms for punishing the corrupt. For individuals who have internal social motivations (such as a desire to reciprocate the actions of others), disguised actions and motivations of others may cause distrust, which may cause them to act opportunistically where they would otherwise act in more benign ways. In sum, this means that a social compact challenged by the lure of natural resource rents, is all the more vulnerable in the absence of transparency.

4 Transparency is insufficient

As shown in the previous section, a lack of transparency can exacerbate corruption related problems in natural resource rich economies. There is also empirical evidence suggesting that transparency is associated with less corruption. Brunetti and Weder (2003) find a strong association between greater press freedom and less corruption, and Suphachalasai (2005) finds that a higher degree of media competition significantly decreases corruption. Several studies argue, however, that the effect of transparency on corruption is not unconditional. In other words, transparency is a necessary, but not sufficient condition to reduce corruption. In addition to access to information, you need an *ability to process* the information, and the *ability and incentives to act* on the processed information.[xx]

Education is a key precondition for the ability of a population, or a more limited group of stakeholders, to process information. There is some evidence that education in itself is associated with less corruption.[xxi] In addition, there is evidence that the effect of transparency on corruption is conditional on education. In particular, Lindstedt and Naurin (2005) provide empirical evidence that the effect of press freedom on corruption is dependent on the level of education. It has been pointed out that resource rich economies often engender economic structures that are not conducive to skill formation. Where the resource sector is dominant, there will be little transition towards industrialization and the creation of a large skilled labour force. Instead, there will be a large unskilled workforce in primary production, and a smaller skilled and politically favoured labour aristocracy in the resource sector, or in protected sectors. The result is large income inequalities and low social capital accumulation, which causes political conflict and obstructs institutional development.[xxii]

Having information on the conduct or performance of public officials is of little avail if other agents do not have the ability to punish abuses of office. The extent to which other agents can hold public officials to account is therefore a condition for more information to result in reduced corruption. The issue of democratic accountability is an important and particularly problematic one in oil rich countries. Several studies find that oil hinders democracy, i.e. that countries that have high revenues from oil, are less democratic.[xxiii] Ross (2001), for instance, finds that oil's harmful influence on democracy extends beyond the traditional 'heartland' of the Middle East, and has probably made democratization harder in states as varied as Indonesia, Malaysia, Mexico and Nigeria.

This is frequently attributed to the so-called rentier effect. By controlling substantial oil revenues, governments can reduce pressures for democratization through patronage, i.e. by providing advantages to supporters for instance in the form of public sector positions. Similarly, where oil revenues are high, there is less need for taxation, and hence less pressure for political representation from the population. Finally, a government may use oil revenues to repress or otherwise obstruct the formation of social groups competing for political influence.

Perhaps the best knows example that access to information may limit corruption is from Reinikka and Svensson (2005). Following surveys in Uganda showing that only 13% of education grants actually reached schools in the 1990s, the rest being captured by local government, the Ugandan government started to publish monthly grants to districts in newspapers. This had a substantial effect on the amounts that schools received, in 2001 more than 80% of grants on average reached schools. Reinikka and Svensson (2005) find that the effect of access to this information on grants received, was statistically significant.

However, a study by Olken (2004) provides an important nuance to this result, by showing that the effect of information depends very much on the incentives to act on reports of leakage of funds. Olken uses data from a field experiment in Indonesia, to show that local participation in village road projects only changed the form of corruption, not its overall level. In the villages where participation was increased, there was reduced theft of villagers' wages, but this was offset almost completely by a corresponding increase in the theft of building materials. Wages are clearly a private good to villagers, in the sense that they accrue to them only, and not to a larger group of individuals. A worker whose wages are embezzled, has a clear interest in reporting and sanctioning the shortfall, since the benefits of doing so accrue completely to him. By contrast, building materials that should have been used to build a road, have more of a character of a public good, where there may be substantial free-riding problems. Providing information is therefore likely to be effective for government activities that provide private goods, such as subsidized food, whereas it is relatively ineffective in the provision of public goods such as infrastructure.

This has implications in terms of the type of information that is provided to the population in resource rich countries. For instance, providing highly aggregate macroeconomic figures on oil revenues (cf. the EITI initiative) or expenditures, is likely to result in collective action problems, where individual incentives to act on the information are weak. An alternative would be to make public information on district or individual entitlements, and the extent to which these are met. This relates also to the discussion of a decentralization of oil revenues, which has been suggested as a means of making oil revenues less appropriable and hence avoiding some of the dysfunctions caused by oil.[xxiv]

Some caution is nevertheless advised in targeting information to topics of private interest. As argued by Keefer and Khemani (2005), citizens are often more easily mobilized to demand private benefits of an inefficient kind, such as subsidies or unproductive public sector employment, than to demand more widely beneficial public goods such as service quality improvements. Information reform designed to appeal to private interests risks feeding into this negative process of patronage and clientilism. Khemani (2006) therefore suggests that information campaigns in developing countries should focus on the quality of service delivery, using objective data and clearly identifying the responsible public officials.

The incentive of citizens to act on corruption-related information also depends on the form of corruption. Where corruption is extortive (that is, a public official demands payment from a private agent for a service or goods that they are entitled to) the existence of effective channels of information (such as a free and active media) can influence extortive corruption by lowering the costs of complaint for private agents. Where corruption is collusive (that is, where the private agent is a willing participant in the corrupt act because it is mutually beneficial), the private agent has no incentive to report corruption.[xxv] This suggests that in oil rich countries where corruption is widespread and most agents implicated in some way, transparency by itself may do little to uncover illicit acts.

5 Transparency may cause problems

Though transparency is important, it is fairly obvious that maximal and all-encompassing transparency is not necessarily optimal. There are opportunity costs to spending resources on informing the public or relevant stakeholders. A public sector that is to always keep the public informed on all details of their activities, will not be very effective in pursuing their activities. In other words, if you keep a diary of everything you do, you won't be doing much. Negotiations may also become more cumbersome, as bargaining parties become more cautious in exchanging relevant information, or in striking deals that may undermine their position in other domains. Confidentiality is also highly legitimate in certain cases, such as in personnel matters.

Bak (2001) points out that while transparency makes it more likely that corrupt officials are detected, it can also identify the relevant officials to bribe. In other words, transparency reveals to potential bribers whom they need to establish contact with in order to acquire an unfair advantage. For instance, a more transparent bureaucracy may make it easier for an oil company to identify the bureaucrats it needs to bribe to circumvent e.g. environmental regulations. In certain cases of small improvements in transparency, the identification effect may dominate the detection effect, and transparency may thus actually increase corruption. For large improvements in transparency, however, the detection effect dominates, and corruption is reduced. The scope of transparency is also central in this context; improving information on how decisions are made, not just who makes them, would produce more beneficial effects.

Certain types of information can also have unintended consequences in a political economy setting. Fox (2007) considers the case where incumbent politicians are better informed on the consequences of actions than the electorate, but where acting on this information could be misinterpreted by the electorate as having an ideological bias. This could lead a politician who cares about being re-elected, to vote against his better judgment. For instance, if a politician knew US oil companies to be more efficient than firms from other countries, he might still favour licences to companies from other countries, in order to not be seen as overly friendly to the US. This could include not acting on information that licences were won through bribery. In these types of cases, making politicians' voting records public could actually produce worse policy decisions. On the other hand, disseminating information on the subject of decision, for instance the efficiency or corrupting influence of oil companies, would have beneficial effects.

It should also be pointed out that increased transparency in the form of more effective channels of information can have undesirable consequences if access to these channels is significantly unequal. Where a government controls information channels, false allegations of corruption against political opponents may be levied, or a government may mount counter-publicity campaigns to fend off allegations against it. Nor can information channels independent of the government always be assumed to be a benign force, the media may concoct false allegations to increase profits, or use information to get access to rents rather than hold a government to account.[xxvi]

6 The many faces of transparency and current initiatives

As the previous section suggests, transparency can, in certain cases, be a double-edged sword. Information is power, but this power can also be abused to gain access to the rents generated by natural resources. Van de Walle (2001) points out that policy reform has been instrumentalized by leaders in many countries to acquire access to rents. Transparency initiatives to a large extent have to be implemented by governments, and their implementation can therefore be expected to be uneven and subject to government interests. Even in the case where there is pressure for reform, transparency is a complex and multi-faceted term, which provides substantial room for manipulation and circumvention.

A deconstruction of the transparency concept provides an illustration of this, and points to further challenges in designing transparency reform. In particular, the many opposites of transparency reveal the number of ways in which information may be contained:

- Secrecy
- Opacity
- Wrong information
- Biased information
- Spin
- Incomplete information
- Inaccessible information
- Unequal access to information
- Information overload
- Irrelevant information

In addition, there are a number of public sector activities in which transparency may be important, which raises questions of coverage, priorities and sequencing of reform to increase access to information. The following is a non-exhaustive list of areas where transparency is important:

- Public revenues
- Public expenditures
- Awarding of contracts/licenses
- Public procurement
- Ownership interests of public officials
- Awarding of positions and promotions in the public sector
- Regulation and facilitation of private sector activities

There has been little research into what areas should be prioritized in improving access to information. One could, however, argue that transparency reform in oil rich countries should focus on those areas that matter the most for avoiding the resource curse. Prominent explanations of the resource curse see institutions as a key factor in its avoidance. Mehlum et al (2006) argue that institutions that make the private sector function efficiently, such as rule of law and bureaucratic efficiency, are the key to making entrepreneurs choose productive private sector employment over unproductive rent-seeking activities. Robinson et al (2006) argue that the key to avoiding the resource curse are institutions that limit the ability of governments to distribute public sector positions to political supporters, which distorts the allocation of resources in the economy. These perspectives suggest that the latter two areas in the above list are the most important to reform in resource rich economies. Most current reform initiatives have tended to focus on transparency in other areas, however.

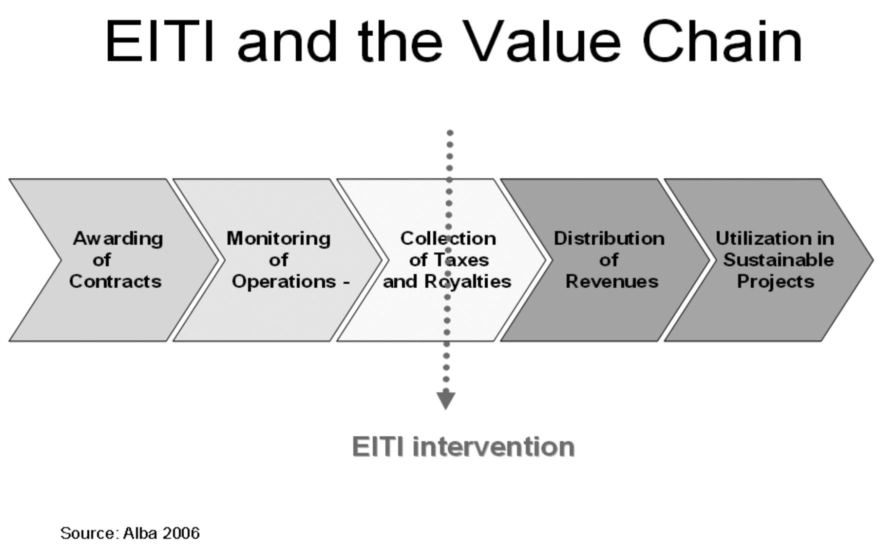
With this in mind, let us look more closely at the Extractive Industries Transparency Initiative (EITI), which is a key initiative in the area of transparency. There are also other initiatives in this area, such as the IMF Guide on Resource Revenue Transparency, the Transparency obligation initiative of the EU, and guidelines by the International Accounting Standard Board. It is, however, beyond the scope of this paper to elaborate on these in any detail.[xxvii]

6.1 The Extractive Industries Transparency Initiative (EITI)

The EITI is a voluntary initiative that supports improved governance in resource-rich countries through the verification and full publication of company payments and government revenues from oil, gas and mining. The EITI is a process initiated by donor country governments in order to reduce resource curse problems by improving governance and transparency.[xxviii] The main motivation for the initiative is that oil rents are seen as the property of the nation. Thus mechanisms to collect, distribute and use the rents should be clear and acceptable to all.

The EITI focuses on one facet of the value chain only; transparency in revenue collection. It does not address upstream activities, such as procurement, which constitute a significant part of the value chain in oil and gas, nor does it cover the distribution of income and public expenditure stemming from extractive industry revenues (see figure 3).

Figure 3. The coverage of the EITI



There are three main groups of stakeholders involved in the EITI process: representatives of the government, extractive industry companies and of civil society and the initiative seeks to build multi-stakeholder partnerships in developing countries.

There are four steps in the implementation of the EITI (cf. figure 4). An evaluation of the EITI undertaken in 2006 shows that, of the 20 countries that have committed to EITI principles and criteria, only:

- Two have published fully audited and reconciled EITI reports;
- Eight have yet to take even the initial step of appointing an individual to lead the EITI process;
- Ten have not yet formed the required multi-stakeholder committee;
- Eleven do not have a drafted and approved work plan.

Figure 4. The EITI implementation process

Implementing the EITI: 4 steps

1- Sign up
- Issue government announcement
- Commit to work with civil society
- Appoint implementation leader
- Compose and publish workplan

2- Preparation
- Establish multi-stakeholder committee
- Engage industry and civil society
- Remove obstacles to implementation
- Agree reporting templates
- Approve auditing company
- Ensure full industry participation
- Ensure company & gov. accounts are properly audited

3- Disclosure
- Verify company and government disclosure to auditor
- Approve audit quality
- Identify discrepancies and recommend improvements
- Summarize industry support to implementation

4- Dissemination
- Agree on manner and quality of dissemination

Source: Alba 2006

The EITI provides a partial basis for accountability in the management of revenue flows from oil and other extractive industries. By comparing the payments made to governments by companies, with the payments received by governments, the revenues to governments are subjected to closer verification than would otherwise be the case. Since substantial amounts are otherwise believed to disappear in the process of collection, this is no doubt important. Nigeria is frequently used as an example of higher identified revenue flows as a result of EITI participation; according to one account the savings made were in the order of USD 1 billion in 2004-2005.[xxix] These types of findings need to be verified more closely, however, since increased revenues may be attributable to a number of factors other than EITI implementation.

The EITI underscores the importance transparency plays in governance. With this emphasis, stakeholders are more aware of potential problems that might arise in the absence of transparency. At the same time, the EITI creates a platform of communication between government authorities, the extractive industry (oil and mining companies including oil service firms) and civil society (press, unions, local and international NGOs). Dealing with resource management involves complex issues that need comprehensive analysis, transparent information and participation from many stakeholders. The EITI also represents an international standard on transparency and good governance, which make it easier for oil companies and government to aspire to better practices, and constitutes a focal point for civil society in addressing inefficient governance, or for financial institutions to use in certification processes.

There are also a number of challenges and problems related to the EITI initiative. Firstly, the EITI is an initiative that focuses on *revenues* from extractive industries in resource rich countries. This implies a narrow take on transparency, as only a small section of the public sector is covered by the initiative. Other parts of the oil extraction value chain are not covered by the initiative. Importantly, the initiative does not address transparency in the use of public resource, i.e. the *expenditure* side. The expenditure side is clearly key to many of the corruption-related problems faced by resource-rich countries. Patronage politics, whereby funds or positions are transferred to supporters, is clearly about the expenditure side. The study by Robinson et al (2006) suggests that accountability in the use of public resources is the key to avoiding the resource curse. There is, therefore, a possibility that the EITI initiative is not only narrow, but that it also gives priority to the wrong set of issues in oil rich countries.

Secondly, EITI affiliation is *voluntar*y for states and companies. This means that countries and companies may choose whether or not to join the initiative, and whether to wholeheartedly follow-up on it if they do join. As we have seen, a country such as Angola has opted not to join the EITI. Whether or not a government chooses to join an initiative of this kind most likely depends on what it has to gain by doing so. As corrupt government officials may have vested interests in not promoting transparency in their country, expanding EITI affiliation and implementation is likely to remain a problem. This relates to the previous discussion of information rents and reform.

Thirdly, as argued in section 4, transparency is, in and of itself, insufficient in improving government behaviour. In the absence of accountability, whereby other groups can hold a government to account and sanction misbehaviour, it is unclear that the EITI will have much of an effect. It is, for instance, unclear that failing to meet EITI criteria will necessarily have any repercussions for a government, in countries where accountability mechanisms are weak. Moreover, in addition to accountability, the effect of the initiative will depend on the degree to which other groups are able to process the information made available, i.e. their level of education. As pointed out earlier, there are also potential free-rider problems in providing highly aggregate data that affect everyone in general but no one in particular. It is likely, therefore, that the EITI needs to be coupled with other types of reform to have an effect on corruption in oil rich countries.

Fourthly, the EITI includes the construction of a multi-stakeholder group to participate in the process, including validation. While this has the potential of improving accountability and participation in revenue management, there is also a risk that the group can become another arena for rent-seeking and patronage. Though civil society is to be represented in the multi-stakeholder group, civil society is neither one thing nor necessarily representative of the population. Since the multi-stakeholder group is to be appointed by the government, there is a chance that it will be peopled with government supporters. Or along the lines of rentier state arguments, a government may use its power of appointment to undermine the existence of social groups independent of the government. And more fractionalistic stakeholder groups may use their potential leverage in the EITI, to acquire a greater proportion of resource rents. This implies the need for a critical analysis of the composition and behaviour of the multi-stakeholder system of the EITI, to assess the commitment of the government to real reform in the area of transparency.

7 Concluding remarks

Transparency has become a popular concept among donors and other policy makers, and several initiatives have sought to increase access to information in oil rich developing countries, including the Extractive Industries Transparency Initiative. This paper reviews the main points about transparency that can be made by applying insights from the literature on information, corruption and development, to a resource rich context. The analysis presented provides a basis for future policy in this area. At the present time, however, the evidence base does not match the popularity of the transparency concept. Transparency is only one of several policies to fight corruption and may need to be complemented by other initiatives. More research on transparency in oil rich countries needs to be conducted, to provide more specific policy advice.

Transparency, or access to information, can have an effect on corruption. Transparency can reduce bureaucratic corruption by making corrupt acts more risky, by making it easier to provide good incentives to public officials, and by easing the selection of honest and efficient people for public service. Transparency can reduce political corruption by helping make politicians more accountable to the public. More generally, transparency can facilitate cooperation over opportunistic rent-seeking and help maintain norms of integrity and trust.

However, transparency has an effect on corruption only under certain circumstances. Agents, whose access to information is increased, must also have an ability to process the information, and the ability and incentives to act on that information. The impact of transparency therefore depends on the level of education of an electorate, the extent to which key stakeholders have the power to hold a government to account, and the private or collective nature of the goods about which information is provided. Transparency reform may also backfire if the type of information provided eases identification of the relevant officials to bribe. Moreover, since government officials may obtain large rents due to informational advantages, transparency reform may be hard to implement.

More fundamentally, though transparency can have an effect on corruption, this does not necessarily imply that increasing access to information should receive the highest priority in addressing corruption in oil rich countries. Fighting corruption in oil rich countries can be done in a number of ways, of which transparency reform is only one. Arguably, priority should be given to the types of reform that have the greatest effect in reducing corruption and/or alleviating the resource curse. Mehlum et al (2006) suggests that the key thing is to increase the profitability of the productive sector, to draw skilled agents out of rent-seeking activities. Kolstad (2007) provides empirical evidence that improving institutions that govern the private sector, such as the rule of law, are more important for avoiding the resource curse than institutions of democratic accountability. From this perspective, it is not immediately apparent that transparency reform focused on increased government accountability should receive high priority. At the very least, the effectiveness of improving transparency should be more systematically evaluated vis-à-vis other policy options.

If transparency in some form is sufficiently important to merit priority, this raises the question of what forms of transparency to promote and how. Current approaches, such as the EITI, have tended to focus on transparency in public revenues. Given the centrality of public expenditure in patronage politics in resource rich countries, the focus on revenues is not necessarily the most effective one for addressing corruption. Nor is the largely voluntary approach of current initiatives likely to have much of an effect where public officials forgo substantial rents by implementing the principles in question. Further analysis of the modes of transparency, the mechanisms by which they matter, and the ways in which they can be implemented, is needed to inform policies in this area.

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Notes

[i] See Robinson et al (2006), Mehlum et al (2006), Leite and Weidmann (1999), and Kolstad and Søreide (2007).
[ii] See Bellver and Kaufmann (2005) for a further discussion of definitions.
[iii] For instance, the two prominent models of institutions and the resource curse due to Robinson et al (2006) and Mehlum et al (2006), do not incorporate informational problems.
[iv] See http://www.freedomhouse.org/template.cfm?page=362
[v] See http://www.iri.org/africa/angola/pdfs/AngolaPollReport.pdf
[vi] One needs to question, however, if this growth is sustainable after the peak of oil production (expected to occur in 2012)
[vii] A bribe might however not be a perfect substitute of wages as there might be moral costs of receiving bribes.
[viii] The results below hold in a simple model where bribes are exogenous. If bribes are endogenously determined, for example in a bargaining framework, some of these results will go the other way (see Mookherjee and Png, 1995).
[ix] Becker and Stigler (1974).
[x] In political science and economics, the problem of motivating one party to act on behalf of another is known as 'the principal-agent problem'. The principal-agent problem arises when a principal compensates an agent for performing certain acts that are useful to the principal and costly to the agent, and where there are elements of the performance that are costly to observe (http://en.wikipedia.org/wiki/Principal-agent_problem). The principal (the uninformed party) moves first (a la Stackelberg) and is imperfectly informed of the actions and/or the characteristics of the informed party (the agent). The theory deals with the design of optimal incentive contracts (see for instance Selanie, 2005).
[xi] Here we assume that the principal is benevolent.
[xii] There is no clear cut answer on how to provide a bonus contract in this example. For a more general discussion on wage incentives and corruption see Besley and McLaren 1993.
[xiii] See Keefer and Khemani (2005). See also Strömberg (2001) for a formal model of the effect of media information on corruption, and Besley and Burgess (2002) on the effect of media on government responsiveness.
[xiv] See Ross (2001).
[xv] See Shleifer and Vishny (1993).
[xvi] See Farrell (1987) for the general argument.
[xvii] See Svensson (2000).
[xviii] It should be noted that more information is not necessarily a good thing in a second best world. For instance, in a prisoner's dilemma game repeated a finite number of times, only the non-cooperative outcome is subgame perfect if both players know each other to be rational payoff maximizers. Given some uncertainty about the type of the other player however (i.e. that he may be a tit-for-tat type), cooperation becomes possible in at least some rounds.
[xix] See Andvig and Moene (1990)
[xx] Moreover, whether the media is an effective channel of information, depends on the extent to which the media is captured by the government, see Besley and Prat (2006).
[xxi] See Svensson (2005).
[xxii] See Auty (2001), and Woolcock et al (2001).
[xxiii] See Ross (2001) and Aslaksen (2007).
[xxiv] See Sala-i-Martin and Subramanian (2003).
[xxv] See Brunetti and Weder (2003).
[xxvi] See Vaidya (2005). See also Kolstad et al (2007) for a summary of the literature on media and corruption.
[xxvii] For more information, see http://www.imf.org/external/np/pp/2007/eng/051507g.pdf, http://ec.europa.eu/internal_market/securities/transparency/index_en.htm and http://www.iasb.org/Home.htm
[xxviii] For more information, see http://www.eitransparency.org/section/abouteiti
[xxix] See http://allafrica.com/stories/printable/200701020805.html

Abstract

Corruption is a serious problem in many developing countries that are rich in oil and other natural resources. This is central in explaining why resource rich countries perform badly in terms of socio-economic development. Transparency has recently been viewed as a key factor in reducing corruption and other dysfunctions in natural resource rich countries. This paper addresses the relationship between transparency and corruption, with an emphasis on oil rich countries. It provides a systematic overview of the available literature and arguments on transparency and corruption. In particular, using the case of Angola, it focuses on some of the main corruption related problems caused by limited access to information. It also looks at the approach of current transparency initiatives, such as the Extractive Industries Transparency Initiative (EITI). The analysis of the paper aims to increase understanding of the role of transparency, thus providing a general basis for subsequent policy analysis in this area. The paper is part of the project 'Corruption in Natural Resource Management' at the U4 Anti-Corruption Resource Centre: www.U4.no

U4 - CMI
PO Box 6033
5892 Bergen, Norway
Tel: +47 55 57 40 00
U4@U4.no

www.U4.no