UNRISD United Nations Research Institute for Social Development

CONFERENCE NEWS

Social Policy in Mineral-Rich Countries

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Introduction

Why do some mineral-rich countries channel their resources into sustainable economic and social policies, while others do not? What are the factors that impede resource-rich countries in the South from investing more of their wealth in social development? Can boosting mineral rents open fiscal space for transformative social policies in a context that is also conducive to democracy, social inclusion and economic development? These are some of the questions guiding research under a project at the United Nations Research Institute for Social Development (UNRISD), *Financing Social Policy in Mineral-Rich Countries*, which is part of the second stage of a broader inquiry, initiated in 2006, *Financing Social Policy* (see UNRISD Conference News No. 18, 2007). The umbrella project, funded by the Ford Foundation, explores the developmental impact associated with specific financing techniques and revenue resources such as taxation, social insurance contributions, social and pension funds, remittances, aid and the topic of this issue of Conference News: mineral rents.

In 2007, UNRISD commissioned eight papers on the theme of financing social policy through mineral rents, which included four conceptual papers and four case studies on Chile, Indonesia, Nigeria and Norway. These papers were presented during a two-day workshop in Geneva on 24–25 April 2008. The workshop brought together commissioned authors as well as academics and experts from the United Nations, including staff from the International Labour Organization (ILO) and the United Nations Conference on Trade and Development (UNCTAD).

In his opening remarks, UNRISD Director Thandika Mkandawire welcomed participants and introduced the UNRISD research programme on Social Policy and Development. This programme is built on the recognition that social policy has multiple roles that go beyond social protection and poverty reduction, simultaneously affecting production, redistribution and gender as well as state-society relations. He explained that the key role social policy plays in terms of economic development, social cohesion and democratization has been shown in UNRISD research on late-industrializing Nordic, East Asian and Latin American countries). In this research it also became clear that the financing question had to be tackled successfully in order to build sustainable development models. Finally, Mkandawire said, he hoped that the workshop would provide an opportunity to share and learn from each other's experiences—across countries and across disciplines—on development, welfare regimes and democratization.

Katja Hujo followed with an overview of the research project. She noted that in a context of globalization, states' capacities to raise revenues had been undermined by processes like trade and capital account liberalization, labour market problems like unemployment and increasing informality, income and asset concentration, and persistent debt problems. At the same time, there was a growing need for social policies in order to compensate for the social costs produced by market volatility and economic crises, to provide income support to increased numbers of unemployed and excluded people, and to manage processes of demographic and social change. At the time the conference took place, the global economy was not yet showing the dramatic signs of the economic and financial crisis, as it was by late 2008, and the international context still presented some positive features such as low interest and inflation rates and high commodity prices, which Hujo characterized as windows of opportunity for developing countries. Describing the links between mineral wealth and social development, she referred to the issue of human resources; the enclave nature of the mining industry and regional income and wage disparities; concerns about fragmentation of national social systems through the creation of privileged schemes for mining employees; problems of armed conflict financed by mineral rents; the relationship between the mining industry and migration; and effects of the sector and related policies on gender and family structures. Hujo concluded by outlining the main research questions guiding the project, which focus on:

- the developmental and distributional impacts of mineral rents and the ways mineral rents affect production, reproduction, protection and re-distribution;
- the link between resource abundance and key social indicators in different countries;
- politics and political regimes that are engendered by mineral wealth, and the implications for social development and social policy;
- promising policies to tackle the macroeconomic challenges associated with mineral wealth, as well as preconditions to make these policies work; and
- policies that could create synergies between social and economic policy, and the possibility of trade-offs between the two.

Following this introductory session, participants were invited to make some initial comments on the broader research framework. This discussion confirmed that direct interaction between mineral-rich countries can make an important contribution to "policy learning" through knowledge sharing about successful development experiences in these contexts.

Different actors like the World Bank, the Norwegian government and international non-governmental organizations (NGOs) are already active in this area. Participants remarked upon the need not only to learn from successful countries, but also to promote a critical stance on one-size-fits-all policies and to move beyond standardized solutions. Especially with regard to newcomers like Mauritania or Ghana, which have recently discovered natural resource wealth, it was deemed useful to engage in ex ante analysis in order to design institutions with the capacity to manage revenues well. Furthermore, participants suggested that the focus on the so-called resource curse, a supposed negative relationship between natural resource abundance and economic growth, had resulted in deterministic views on the development implications of mineral wealth and produced confusion among developing countries—leading, for example, to the paradoxical conclusion that a country would do better to avoid finding oil and other natural resources in order to grow. The real challenge for mineral-rich countries, it was emphasized, is to develop the capacity to absorb funds from the mineral sector and allocate them to productive and social investments. Unfortunately, this capacity and the institutions that traditionally served to carry out such functions were weakened, and even dismantled, during the neoliberal adjustment era.

Session 1: Economic Challenges and Potential in Mineral-Rich Countries

The first thematic session of the workshop dealt with economic challenges, growth performance and economic policy responses in mineral-rich countries. Although the challenges associated with mineral rents are well known and common to all countries, economic policy responses vary considerably. The range of

mechanisms for coping with the threat of Dutch disease,[1] as well as different approaches to manage and allocate revenue streams from minerals, generate different outcomes. The two papers presented in this session show that both national and international factors influence the economic performance of mineral-rich countries. However, they place a stronger emphasis on the significance of internal variables—institutions and governance, investment in human capital and sound macroeconomic policies.

Samuel Asfaha gave the first presentation of the session, on "Economic Policy in Mineral-Rich Countries". According to Asfaha, resource-rich countries have to deal with the issues of volatility and long-term sustainability of prices and revenues. In addition, various problems have been identified in mineral-rich countries: the already mentioned resource-curse literature establishes a negative correlation between mineral wealth and economic growth as well as standards of living and democracy; many analysts also see fertile ground for social conflict, poor economic policy management (which explains a tendency to fall into the Dutch disease trap), and heavy borrowing. Additionally, some of these countries are victims of overconfidence with regard to the sustainability and magnitude of flows, which leads to a "rent-seeking mentality", in the sense that the development of productive activities is increasingly neglected. Policies end up being influenced by politically connected interest groups at the expense of entrepreneurialism, which subsequently turns policy makers away from social interests.

Asfaha argued that the effect of natural wealth on development depends on how it is managed. To illustrate this, he suggested two extreme scenarios. In the first, the government spends all the proceeds of a mineral boom on consumption, leading to real exchange rate appreciation and Dutch disease symptoms, which further fuel consumption, increase production of non-traded goods and cause a real contraction in the non-resource tradable sector. In the second, the government invests the windfall proceeds of the boom in productivity-augmenting projects, with which a country can produce more of both traded and non-traded goods. The second scenario is associated with growth and increased productivity, which reflects an escape from Dutch disease.

Asfaha explained that in the less successful empirical cases, most expenditure was in the form of over-expanded public sector employment; wages and transfers; and subsidies on food, fertilizers and petroleum. Some ventures could even be characterized as "white elephants" in which political prestige was the sole driving force or in which funds were used to complete obsolete projects or to prop up inefficient enterprises with few or no linkages to the productive sectors of the economy.

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According to Asfaha, the prudent approach is to accumulate savings during booms for sustainable financing of investment projects during busts. This requires fiscal policy to be countercyclical in order to avoid situations where revenue volatility is translated into expenditure volatility. He cited the cases of Mexico and Nigeria to illustrate the effects of pro-cyclical policies, where aggressive expenditure of windfall oil revenue was paralleled by a significant increase in external debt. This stifled growth beyond what would have resulted solely from a fall in commodity prices. Asfaha then demonstrated that the resource curse can be reversed with effective policy management. Countries like Botswana, Indonesia and Norway accumulated huge reserves *and* maintained macroeconomic stability. For these countries, the return on assets invested represents a significant source of revenue, more or less equal in importance to customs and excise revenues. However, Asfaha cautioned, when funds are readily available and

[1] Dutch disease refers to rising inflation rates and exchange rate appreciation produced by capital inflows. As a consequence, domestic production becomes less competitive in world markets, adversely affecting the country's trade balance. In the longer term, investors tend to shift their resources into the non-tradable sector.

known to be available, exceptionally strong institutions are required in order to maintain fiscal discipline.

Rent-seeking behaviour, incited by the considerable returns to those who are able to capture mineral rents, may lead to a concentration of economic and political power in the hands of elites, and may breed corruption. A reduction of efficiency and social equity as a result of rent-seeking behaviour has been reported for oil-rich countries like Mexico, Nigeria and Venezuela. Policies tend to benefit groups that policy makers, or their associates, are linked to. In these cases, policies are guided by short time horizons that prioritize the government's short-term political gains, often at the expense of long-term economic development. This is a problem that arises if elite interests are not linked with the interests of production-based groups, as they are in more successful cases such as Botswana.

Asfaha ended his presentation by pointing out some recent international policy initiatives (such as the international transparency initiative, or the World Bank's engagement in Chad) that aim at greater transparency in the management of mineral revenues. He expressed doubts that these initiatives alone would be sufficient to alter the political and economic incentives faced by governments in mineral-rich countries.

The second thematic paper presented in this session was "Development and Growth in Mineral-Rich Countries", by Thorvaldur Gylfason. He presented empirical evidence based on newly published data sets

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that shed light on the general hypothesis that natural resource *dependence* may hurt economic growth in developing countries, although resource *abundance* in advanced countries seems to be beneficial. Gylfason identified economic and political diversification, investments in social and human capital, as well as democracy and good institutions as important factors to explain and enhance positive growth and development performance.

According to Gylfason, social development and economic growth are closely intertwined. When social indicators of life expectancy, fertility and literacy have high levels, this conveys a clear and consistent picture of progress, and sometimes a more accurate picture than more commonly used economic indicators. However, apart from education and health care, social policy issues have been absent from much of the recent academic debate on economic growth.

Gylfason then summarized debates surrounding the relationship of economic growth and income distribution. One well-established hypothesis is that income inequality is a catalyst for real capital accumulation and growth, given the large numbers of rich people inclined to save. In this line of reasoning, income redistribution would reduce savings, slow the accumulation of capital, and thus reduce investment and growth. Another hypothesis suggests that income inequality endangers social cohesion, political stability and peace, thus spoiling the investment claim; in this view, it also triggers counterproductive demands for redistribution, reducing efficiency and growth. Even though the theoretical literature behind this is ambiguous and inconclusive, Gylfason claims that there are strong a priori and empirical grounds for believing that social expenditure—and social policies more generally—*do* matter for economic growth. Specifically, he said, saving and investment, education, training, health care and family planning, absence of corruption, democracy and macroeconomic stability are important factors for growth.

Gylfason went on to explain how natural capital influences other kinds of capital or their determinants. First, abundant natural resources may blunt private and public incentives to save and invest, slowing economic growth. Second, natural capital may crowd out human capital by weakening private and public incentives to give a high priority to education. And third, mineral-rich countries tend to be marred by rent seeking on the part of producers who divert resources from more socially fruitful economic activities; as mentioned in the previous

presentation, this may lead to a concentration of economic and political power.

Using recent data for 164 countries from the World Bank, UNCTAD and Transparency International, Gylfason then presented the results of various regression models. His first finding was that school life expectancy[2] is inversely related across countries to natural resource dependence as represented by the share of natural capital in total wealth. This would indicate that natural capital tends to crowd out human capital. The second finding was that corruption perception is positively correlated across countries with the share of natural capital in total wealth but inversely correlated with the growth of per capita GDP. Democracy was found to be inversely correlated with the share of natural capital in total wealth across countries, while growth was positively correlated with democracy. These results would support the conclusion that natural capital tends to crowd out social capital and hurt growth. The third finding was a close positive cross-country correlation between school life expectancy and democracy, with each additional year of schooling going along with an increase in democracy by one point, supporting the argument that human capital and social capital go hand in hand. The fourth result highlighted by Gylfason was that different aspects of social capital are likely to interact and to reinforce each other, as indicated by the inverse correlation between democracy and the perception of corruption.

Gylfason went on to identify two ways in which natural capital influences economic growth. On the one hand, an increase in the share of natural capital in total wealth reduces economic growth. On the other hand, an increase in natural capital per person stimulates growth. It should be noted that an increase in the natural capital share tends to reduce growth in developing countries, but may increase growth in industrialized countries.

In concluding his presentation, Gylfason summarized the main arguments of his paper. First, he said, diversification is good for growth, as it allows a country to move away from excessive reliance on natural resources and from narrowly based political elites towards full-fledged democracy. Second, social policy and human capital (including social insurance, education and health care) play a positive role in enhancing growth. Third, Gylfason argued, a judicious use of natural resources requires good institutions, which includes democracy. Finally, he concluded, adequate strategies to turn natural capital sustainably into human and social capital are yet to be developed.

Discussion

The follow-up discussion was chaired by Janvier Nkurunziza, with Katja Hujo and Albert Berry as discussants. One of the main issues addressed by Hujo with regard to the Asfaha paper had to do with the economic policy needed to combat Dutch disease. She suggested discussing this question in the wider context of the literature on developmental impacts of capital inflows: one precondition to avoid destabilizing effects of capital inflows is to have relatively well-functioning institutions to conduct fiscal, monetary or social policy to respond to these flows. For example, reducing the supply of domestic currency through monetary sterilization is difficult without a central bank managing a sufficiently large monetary base. She then referred to the advantages and disadvantages of devaluating the exchange rate or of exporting capital (for example through reserve accumulation) in order to combat Dutch disease. There are valid reasons why governments are reluctant to devalue, as it is not easy to avoid devaluation-debt/revaluation-inflation cycles, potentially leading to bankruptcies in the productive and financial sectors, dollarization and capital flight. With regard to reserve accumulation or investment of funds abroad, she held that these measures (which aim at stabilization) could conflict with the need to channel funds into social expenditure or other investments. Those different objectives had to be carefully balanced. And lastly, she noted how uncomplicated it was to find fault with a policy *after* it has been implemented. If we look at countries that were praised for their economic model but then fell into crisis, and others that were criticized for their unorthodox approach but nevertheless performed well, can we still claim that what the mainstream calls "good policies" provide the sufficient conditions for growth and development?

[2] School life expectancy is the total number of years of schooling a child can expect to receive, assuming that the probability of his or her being enrolled in school at any particular future age is equal to the current enrolment ratio at that age.

Nkurunziza raised the need for a dynamic analysis. Nigeria, he explained, had repaid most of its external debt because of the recent oil boom, and it had also successfully restructured its banking sector. It would be proper to study such positive signs in contemporary Nigeria and analyse what had prevented the country from showing such signs earlier. He confirmed the opportunity costs of avoiding Dutch disease through reserve accumulation and suggested that greater attention be paid to issues such as capital flight, crowding-out of other revenues by mineral rents and the external dimension of policy making in mineral-rich countries as exemplified by the World Bank–Chad cooperation.

Mkandawire commented that it was necessary to analyse the forces that incite governments to use fiscal surpluses in particular ways. The strength or weakness of civil society or trade unions, as well as other contextual factors, are important to explain why some governments spend and others do not. With regard to the discussion on the concepts of rentier state versus rent-seeking, he recalled that the term rentier state referred to the revenue base of a country, whereas rent-seeking described the behaviour of capturing rents.

In his comments on the presentation by Gylfason, Berry stated that the challenge of effective social policies in mineral-rich countries was indeed a key challenge of our times. Indeed, export booms invite spending on non-tradables, but not necessarily on health and education. While underlining the need to incorporate social policy concerns early on into development strategies of mineral-rich countries, he recognized the difficulties in choosing the right timing and focus of such policies, especially with regard to investments in human resources, as uncertain and changing comparative advantages and patterns of diversification in these countries made planning a challenging task.

With regard to the argument that smaller family size allows for higher per capita investments in education, Berry mentioned the possibility of reverse causation, where higher per capita income due to faster growth slows population growth. In addition, he argued, the strength of the argument regarding the relationship between family size and investment in education needs to be reconsidered both in light of the social return on education and the willingness as well as capacity of the state to invest in children from low-income families, and the actual educational spending of small families. A different transmission channel from mineral rents toward low educational investments could be inequality, as mineral rents are associated with income inequality which in turn is correlated with less education. Finally, Berry emphasized the importance of case studies in order to approach the institutional question with regard to legal, economic and social policy issues.

One participant acknowledged that even though Gylfason's presentation and related paper made the innovative move toward linking questions of growth performance in mineral-rich countries with social policy, the analysis was situated within the framework of new growth theories with their emphasis on investment in human capital (health and education), and this is a somewhat narrow approach to social policy and development in general. Also, the focus on growth rates sidelined the fact that most governments are actually interested in "level" effects—that is, if mineral rents allowed countries to make a jump in their income level, then low to moderate growth rates would not be considered a problem. This raised the related question of how mineral-rich countries could embark on more fundamental structural transformations that would diminish the reliance of future generations on mineral revenues. Botswana was mentioned as an example where macroeconomic stability went hand in hand with low structural transformation and poor social development. In this context, another participant added that the crucial questions revolved around maximizing rents and appropriating rents. The second aspect leads to issues of taxation of rent, which actually minimizes distortions in the economy and provides revenue for social investment.

Given the presentation's emphasis on increasing human capital, and education in particular, the higher rate of return on investment for poor people was acknowledged to make sense from a microeconomic point of view. However, in a macro context the positive growth effect would depend on employment opportunities and the characteristics of labour markets.

Some participants also expressed doubts about the research finding that democracy increases efficiency and growth. It was argued that there is no such thing as

a natural development path based on a political system. Voting power is not enough to determine standards of living.

The discussants and other participants also commented on the econometrics and correlations used, their validity and the fact that they do not represent causation. The fact that social relations are usually left out of such an analysis was deemed problematic. There was also a proposal to use dynamic growth models to look at changes over time, in order to verify whether experiences had been different in other periods.

Session 2: State Capacity and Social Policies in Mineral-Rich Countries

Can revenue from mineral extraction constitute a sustainable source of finance for social policies? What are the linkages between mineral wealth, social policy and human welfare? What are the roles of domestic institutions and state capacity in mineral-rich countries? These are some of the questions explored in the papers presented during this session. Both presentations emphasized tax systems as a key element linking mineral production and social expenditure. They also emphasized the importance of firmly establishing social priorities in political agendas and of forming strategic alliances to support these.

> ***Both presentations emphasized tax systems as a key element linking mineral production and social expenditure. They also emphasized the importance of firmly establishing social priorities in political agendas and of forming strategic alliances to support these.***

Evelyn Dietsche's presentation on "Institutional Change and Developmental State Capacity in Mineral-Rich Countries" had two objectives: first, to critically assess the role of institutions and the domestic conditions for institutional change in mineral-rich countries; and second, to explore in more detail how resource extraction is taxed, and what impact fiscal regimes and the concepts that have guided their design may have on the prospects for building state capacity. Given that not all mineral-rich countries have failed to promote development, she challenged the hypothesis that negative performance is inevitable. At the same time, however, there is no consensus in the literature on the factors that have driven economic and social development in these countries.

In her presentation, Dietsche noted that while the quality of institutions matters, it is important to identify the conditions under which institutions change. If countries are able to improve the quality of their institutions, this contradicts the supposed inevitable negative outcome produced by resource exploitation (that is, the resource curse). She bemoaned the lack of discussion on how institutions actually change and the requirements for bringing about such change. She argued that a negative institutional legacy can only be overcome if there is scope for policy actors to introduce a process of positive institutional change despite prevailing structural conditions. However, there is neither theoretical nor empirical clarity about the conditions that favour such action.

Dietsche also noted the measurement problems regarding what constitutes a "good institution". How should institutions and their quality be assessed? Often, what is viewed as constituting a good institution is based on subjective assessments by particular interest groups, and not on objectively acquired knowledge. According to Dietsche, successful countries are characterized by the ability of policy makers to build a state apparatus that provides an effective infrastructure for advancing economic and social development.

She then went on to discuss the conditions for institutional change, particularly in relation to revenue policies and political bargaining over resources. In the context of distributive struggle, convergent economic interests of two or more relevant social interests groups can tip the political balance toward positive institutional change. It is less clear when and how such convergences evolve, and who the winners and the losers are. Inefficient outcomes can also arise in such struggles, if potential losers block change, or potential winners cannot credibly commit to compensating powerful losers.

Dietsche next discussed the role of taxation in state capacity building. Resource extraction allows governments to generate revenue with relatively little public administrative capacity and without taxpayer representation in fiscal decisions. In turn, broad-based taxation benefits the quality of institutions and governance because the imperative to raise revenue on mobile assets provides a positive stimulus for state capacity building. This is due to the fact that mobile resources (income, capital and, to a lesser degree, labour) have the option to exit, if there is no minimum consensus on the tax policy. The relative bargaining power of different interest groups is important to understanding how to build state capacity and to change existing institutions toward better management of assets and revenues.

Might the design of fiscal regimes contribute to undermining state capacity building and institutional change in the long run? Regarding fiscal regimes as they apply to mineral taxes, Dietsche summarized two types: royalty/tax systems and contractual systems. Royalty/tax systems allow companies to take full control of production processes, and in return they pay taxes and royalties. The fiscal terms are usually set unilaterally by the government or negotiated with private investors. These systems are more typically found in developed countries where legislation spells out the tax policy for the sector. Contractual systems include production-sharing contracts and service agreements. These are found more often in developing countries. Fiscal terms, which are often kept confidential, are typically negotiated between the executive and foreign investors.

According to Dietsche, theory suggests that taxation of the mineral sector should focus on taxing the resource rent, which should be shared fairly between the government and the extracting company. A country interested in long-term viability would leave a sufficient share of the pure rent to companies in order to retain investors' interest in the development of the resource sector. Taxing the resource rent involves moving away from taxing production and toward taxing profits. But this poses a problem for countries with low administrative capacity, since administrative processes and enforcement of profit-based taxation tends to be more difficult and requires that governments wait longer to receive their fair share of the resource rent.

Dietsche noted that the political economy of taxation predicts that greater resource revenues undermine state capacity building and truncate institutional change. This proposition raises the question of the conditions under which mineral-rich countries might nevertheless be able to pursue positive institutional changes. She suggested three possible scenarios: (i) if immobile asset holders can align themselves with domestic constituents with whom they share a common interest with regard to the management of assets and revenues, so as to achieve positive development outcomes; (ii) if other domestic social and political conditions (such as effective veto powers by political constituencies) push political elites to seek legitimacy and build state capacity, despite the independence from broad-based revenue collection granted by mineral revenues; (iii) if the taxation of the mineral sector produces some form of administrative capacity which also serves the efficiency of resource revenue spending.

One of Dietsche's main conclusions was that the key challenge for mineral-rich countries is not a purely financial one; to aim at more revenues—as a number of countries have done until recently—is not sufficient. The main challenges were political and social, she argued, in the sense that those who could influence policy making need to gain an interest in the pursuit of social policies that are effective for development.

Following Dietsche's presentation, the thematic paper titled "Social Policy and State Revenues in Mineral-Rich Countries" was presented by its lead author, Leonith Hinojosa-Valencia. She began by outlining the context in which mineral exploitation was expanding: growth of the world economy since the 1990s, which had increased demand for mineral resources, and the shift of activities and expenditures in the mineral sector from the industrialized to the developing countries. As a result, said Hinojosa, there was a growing recognition that the inflow of wealth generated by natural resource exploitation might create opportunities for mineral-rich developing countries to implement social policy in order to increase their citizen's social welfare. Hinojosa's presentation examined the extent to which state revenue and mineral export dependence are connected, and their likely effect on social expenditure.

Hinojosa expressed two concerns regarding the relationship between transformative social policies and mineral development: (i) whether revenue from mineral extraction can constitute a sustainable way to finance social policies; and (ii) whether the exploitation of mineral resources undermines the productive development of the economy as well as the political balance needed to maximize welfare and growth.

Hinojosa noted that many of the pessimistic conclusions found in the literature about the mineral sectors and overall social welfare are drawn from cross-country studies that rely on comparisons between mineral and non-mineral economies, and sometimes even between developed and less-developed countries. These studies introduce, but do not address explicitly, a number of factors (other than mineral wealth) that can explain the disparate outcomes in terms of economic performance and welfare. To overcome such shortcomings, Hinojosa and her coauthors focused their analysis exclusively on mineral-dependent countries in order to expose relationships between mineral wealth, state revenues and public expenditure in social services. The inquiry was founded on three main assumptions.

First, she remarked, in mineral-dependent countries the level of state revenue that is derived from the mineral sector and can be used for social policy purposes is not associated with the degree of mineral export dependence. Mineral-rich countries do obtain fiscal benefits from mineral exploitation, especially in the long term, based on their taxation method. The question is whether these methods are adequate to bring sufficient revenue. The fear that taxation will repel investors and the fact that there is no ideal tax system should also be taken into consideration. According to the results of the regression models, Hinojosa said, there is no particular relationship between a competitive economy, capable of attracting more investment based on lower taxation, and the welfare outcomes it may be able to generate through state revenue. For instance, while Sweden and Chile have been able to develop a welfare state regime with a strategy of lower tax rates, other mineral-dependent countries could have achieved the same despite—or perhaps because of—high taxes imposed on mining investments.

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Second, Hinojosa argued, in mineral-dependent economies the linkage between mineral wealth and social policy occurs through four dimensions. Thus, mineral wealth has the potential to encourage higher levels of social expenditure, to create fiscal space for social policy, to influence the composition of social expenditure and to enable social policy initiatives to get started. According to the correlation and cluster analyses conducted by Hinojosa and her colleagues, the association between revenue and expenditure in social sectors was found in each instance to be positive and significant; similar results were reported for tax revenue. However, there were mixed results in the correlations between taxes on income, profits and capital gains, and expenditure in social sectors: negative in the case of health care but positive in the case of education. This suggests that the higher the mineral dependence, the lower the revenue that is captured by governments and, hence, the lower the amounts allocated for expenditure in social sectors. The evidence was less conclusive in regard to the allocation of mineral tax revenues among sectors, even though it seemed to favour the education sector. According to Hinojosa, these results could be accounted for by looking at the nature of the government (authoritarian or democratic) and the role of civil society in protecting social spending, particularly in education. In that sense, and taking into account the hypothesis that governments in mineral-dependent countries would use additional mineral budgetary resources in those sectors (and places) where more political pressure is observed, Hinojosa suggested that the final effect of mineral resources on the composition of social expenditure could depend upon the balance between social forces.

In terms of the effects of mineral wealth on the composition of social expenditure as a way of assessing what consequences, if any, mineral wealth produces on the welfare mix, Hinojosa showed that mineral wealth

does not seem to significantly affect the welfare mix compared to what would be observed otherwise without it; on the contrary, mineral wealth appears to reinforce it.

As a final reflection on the second assumption, Hinojosa explored the ways in which mineral wealth may influence the trajectory of new social policy initiatives. In a context of extractive industries expansion, organized reaction of civil society groups, as well as of companies, would seem to reinforce the role that ideologies play in defining a particular welfare mix, as well as its financial basis. Indeed, she recalled, recent studies on the Andean countries have suggested that civil society organizations have shaped the social responsibilities adopted by corporations in the mining sector and influenced the positions assumed by governments regarding the relationships (and trade-offs) between mineral investment and people's rights.

Hinojosa then introduced the third and final assumption which states that in mineral-rich developing countries, the capture of mineral revenue by the state and its correlated expenditure in social policy depends on the quality of government.

> ***The formulation and implementation of social policy could produce not just improvements of social welfare conditions, but also a transformation of the state itself, by enhancing the functioning of government and opening up spaces for mechanisms of good governance.***

Hinojosa reported the results from the quantitative analysis, which suggests that in many mineral-dependent developing countries the institutional apparatus is only partly prepared to take advantage of mineral resources. Thus, Hinojosa and her coauthors suggested, the formulation and implementation of social policy could produce not just improvements of social welfare conditions, but also a transformation of the state itself, by enhancing the functioning of government and opening up spaces for mechanisms of good governance. However, she called for caution regarding the channels through which social policy could play such a transformative role in contexts of mineral expansion. While in some mineral-dependent countries the quality of government might be enhanced through policy and institutional change (including formal and informal institutions), deeper structural change in the state apparatus may be needed in others. This, she remarked, requires further understanding of the ways in which mineral development produces incentives, alliances and conflicts that influence the trajectories of state formation, and, hence, greater attention to its impact on governance.

In the final part of her presentation, Hinojosa sketched out the main components of a framework to address the linkages between state revenues and social policy in contexts of mineral wealth. There is not enough evidence to support any simplistic argument about the relations between mineral dependence, social policy and human welfare. Therefore, one point of departure is that fiscal space opened up by the revenue capture from mineral sectors can be used for a number of social policy purposes that can range from extending existing policies to complementing what already exists. Should the purpose of public policy be to achieve some acceptable level of social welfare, it was suggested that mineral wealth is a *second order conditioning factor* which, wherever it occurs, could be used in a way that best responds to established social priorities, determined by *first order conditioning factors* such as political consensus and an agreed development strategy.

Such a framework to address social policies in contexts of mineral wealth would include the findings presented thus far but also the first order conditioning factors. The framework, Hinojosa argued, could be useful for understanding and assessing the influences of mineral wealth on the configuration of a social welfare mix and, hence, for social policy design. Thus, it would help to identify areas where social policy could foster, strengthen or correct paths of social welfare.

Hinojosa concluded her presentation by referring to possible future research on the topic. This could include country and comparative case studies on the effects of mineral expansion on welfare regimes, and inquiries into the effects of mineral expansion on the emergence and development of domestic markets (particularly

labour and financial markets). Research on the structural and institutional conditions under which the connection between mineral expansion and social policy can lead to development was also suggested.

Discussion

In the follow-up discussion, chaired by Yusuf Bangura, discussant Halvor Mehlum began by pointing out the complexity of institutions and their policies. He argued that institutions are necessary in order to provide incentives that are producer friendly and not "grabber friendly". With regard to good or bad institutions, he held that it is not a matter of good or bad intentions, but rather whether institutions can withstand (or not) the pressures they will inevitably face. For example, inflation targeting pursued by the central bank in Norway helped to discipline fiscal policy, especially as important voter groups had mortgages with flexible interest rates. These voters therefore had an interest in maintaining price stability at low interest rates and monitored the government on this.

Anthony Hall was the second discussant. His first remark related to the final conclusion that despite the observed inability to draw clear relations between mineral dependence, social policy and human welfare, there was a potential link between revenue generation as a second-order condition for social development. In this context he emphasized the importance of understanding the political economy, history and social policy drivers of a country as a starting point. Case studies like that of Ecuador tell an important story about the role of governments, corporations, external actors and other groups, such as indigenous people, with regard to social policy programmes and revenue allocation. Although in his view generalizations have to be handled with care, suggestions as to how countries can reinforce redistribution would be helpful. This type of analysis would move beyond looking at social policy instruments in technocratic terms that are focused mainly on efficiency aspects.

The discussion then moved toward debating how specific countries deal with the issues brought up by the presenters and discussants, and how they use revenue from mineral resources. Chile moved from the nationalized system of the early 1970s to a mixed system in the 1980s. Between 1990 and 2005, transnational mining companies in the copper sector accounted for 70 per cent of national production, but then the notion of rent re-entered policy debates and the state reconsidered how to capture this rent for development purposes. In Zambia, the former state-owned copper industry was privatized with the result that the country received little revenue from the huge profits made in this sector. One participant mentioned that it was puzzling that, when talking about corporations, people refer to profits but when they talk about states, they refer to rents.

Whereas the necessity to bargain about revenue shares and to renegotiate contracts between countries and companies was mentioned by several participants, the argument that mineral revenues had to be protected from "political interference" was also discussed. In this sense, it was argued, it is reasonable to put in place mechanisms that tie the hand of government entities that receive money from natural resources. One participant said that since natural resources offer a source of "easy money" to governments, international institutions such as the World Bank and the International Monetary Fund were right in emphasizing conditionality in loans. Here it was added that conditionality could be useful if it allowed governments to pursue "good" policies and externalize the responsibility for them vis-à-vis their electoral constituencies.

This perspective was contested by another participant, who argued that the IFIs' conditionalities had induced massive policy failures and taken a huge toll in terms of people's lives and countries' development performance. Finally, the fundamental problem between democracy and technocracy was mentioned. If democracy really matters, everything that could undermine it should be questioned. The topic was wrapped up with the argument that technocrats can be a good complement to pressure groups if they focus on issues that would otherwise be neglected.

Session 3: Mineral Rents and Social Policy in Norway and Chile

Norway and Chile stand out as successful cases within the group of mineral-rich countries. In both, mineral rents represent a significant proportion of exports and government revenue, although the latter is less significant

in Chile than in Norway. As mentioned earlier, mineral-rich countries share a common set of macroeconomic pressures and challenges. However, compared with other mineral-rich countries, Norway and Chile have achieved very different human development outcomes. Both rank high in terms of human development, which is usually attributed to a combination of sound economic policies, strong institutions and a commitment to development and poverty reduction.

Halvor Mehlum was the first speaker of this session, presenting his coauthored paper on "Mineral Rents and Social Development in Norway". The study highlighted the dimensions along which Norway differs from resource-abundant countries with less favourable development performance. Even though Norway was a poor country just a century ago, it now offers a broad welfare programme and is the world leader in per capita income. According to Mehlum this is due to a combination of economic opportunities and political decisions. His main argument was that for countries with high-quality institutions—and in particular those that manage to secure strong protection of property rights and low corruption—natural resources contribute positively to development, as they provide investors with new investment opportunities and create positive externalities for other agents. Without functioning institutions, however, natural resources might stimulate predation, rent-seeking and other harmful activities with negative externalities for the rest of the economy.

> ***For Norway there was no resource curse because of the existence of good institutions and the provision of incentives for the productive use of oil wealth.***

Mehlum said that different types of natural resources are likely to have a different impact on growth—the impact of oil and minerals may be different from forests or agricultural goods, for example. He noted that regression analyses usually include all types of resources without distinction. Instead, he suggested conducting more differentiated research on this issue in order to gain more substantive insights into the economic and political implications of different natural resources. A particularly striking element, in his view, was the fact that a "challenging resource" like oil had not been problematic for Norway. He posited that for Norway there was no resource curse, first, because of the existence of good institutions and the provision of incentives for the productive use of oil wealth, and second, because the technical expertise developed for offshore oil extraction had positive spillover effects for the rest of the economy.

For Mehlum and his coauthors, this positive performance in Norway is explained by strong democratic governance based on broad political representation with checks and balances in civil society. A functioning state bureaucracy was already in place when oil was discovered, as well as a developed industrial sector with strong trade unions and employers' associations. He also argued that parliamentary systems such as Norway's—as opposed to presidential rule—tend to favour redistributive public spending on universal programmes that benefit all citizens. Spending oil revenue on social services and social security had another advantage in terms of equity, he explained. Tax cuts or gasoline subsidies, both of which are common in oil countries, usually favour higher income groups, whereas social expenditure on health and education stimulated growth by fostering the accumulation of human capital.

Another distinctive feature of the Norwegian model is the tradition of consensus building over policy choices that have long-term implications for the nation. There is a remarkable continuity in the management of the oil sector, and policy makers, regardless of ideological orientation, have managed to stabilize revenue volatility through countercyclical policies. High savings rates have been equally important to escape the resource curse, although the regression analysis supporting this claim does not explain the underlying causality.

Finally, the creation of the Norwegian Petroleum Fund in 1990 and the establishment of strict rules regarding the use of the fund's surplus helped to foster intergenerational equity (the fund is meant to finance future pensions) and to avoid expansionary fiscal policies that could endanger macroeconomic stability in the country.

The case study on "Mineral Rents and Social Development in Chile" was presented by Juan Carlos

Guajardo. He explained how Chilean history was closely tied to minerals. In his view, the general impact of mining has been positive for the development performance of the country. Fortunately, important lessons on excessive dependence on mineral resources, especially with regard to state revenues, were learned during the early periods of mineral production and shaped subsequent policy approaches. During the nitrate cycle between 1880 and 1931, tax income generated by nitrate production represented 42 per cent of total government earnings, but between 1932 and 1945 this fell to only 14 per cent. The production of synthetic nitrates at a lower price and the world crisis of 1929 marked the end of this mineral boom. From then on, fear of product substitution processes and price fluctuations led to demands for higher national participation in the management of the country's natural resources. It was increasingly emphasized that there was a need to diversify the economy in order to avoid mining enclaves and excessive fluctuations of public revenues.

At the beginning in the twentieth century, copper came to dominate the Chilean economy. The industry was developed with substantive investment from the United States, which generated debates about the implications of foreign control of the sector. In 1955, the Chilean government gained more control over the copper industry, which was finally nationalized in 1971 on the basis of a constitutional reform with broad parliamentary approval. Some privatization of mining properties was promoted between 1973 and 1990 during the rule of Augusto Pinochet, while CODELCO, the national copper enterprise, remained a state-owned company. However, only the return to democratic rule in 1990 generated the necessary political stability to attract significant foreign investment: private mining has grown, on average, 16 per cent annually since 1990 and represented 69 per cent of total national copper production in 2007.

More recently, Guajardo noted, the debate over the contribution of private mining to development became a top national issue and led, in turn, to a new law in 2005 that established a specific tax on mining activity (Royalty 2). This was deemed necessary for two main reasons: first, to strengthen innovation and productive development in an economy that relied strongly on non-renewable resources; and second, to generate the necessary financial means to respond to the high expectations regarding economic and social policy that democratic leaders in Chile were confronted with.

Indeed, as Guajardo went on to explain, although there was no direct relationship between mining revenues and social spending, as taxes were not earmarked for specific expenditure purposes, mining generated more public revenues than any other sector in the economy, representing 35 percent of total revenues in 2006. This allowed the democratic governments after 1990 to increase social spending and to tackle the 'social debt' that had accumulated during the years of dictatorship, when expenditure on social policy had been sharply reduced. Social policies in Chile followed the principles of decentralization, private sector participation and targeting of benefits toward the most vulnerable groups. In combination with what is usually described as prudent fiscal and macroeconomic policies, Chile succeeded in creating high growth with low inflation rates, reduction of public debt, falling unemployment rates, increases in real salaries, reduction of poverty rates and last but not least, a diversification of the economy based on natural resources (mainly agricultural) other than mining. As such, Guajardo said, there seem to be no signs of a resource curse in Chile.

> ***In Chile, mining generated more public revenues than any other sector in the economy, representing 35 percent of total revenues in 2006. This allowed the democratic governments after 1990 to increase social spending and to tackle the 'social debt' that had accumulated during the years of dictatorship.***

One of the major institutional improvements achieved by Chile based on historical lessons is the fiscal policy built on the concept of a central government structural balance, in effect since 2001. The structural balance reflects the medium-term fiscal outlook and involves estimating the fiscal income that would be obtained net of the impact of the economic cycle (the level of economic activity and the prices of copper and

molybdenum, a by-product of copper production), and spending only the amount that would be compatible with this level of income. In practice, this means saving during economic booms, when revenues known to be of only a temporary nature are received, and spending the revenues in situations when fiscal income drops.

Among the benefits Chile has gained in applying the structural balance concept are the implementation of a countercyclical policy; the increase in public savings during periods of strong growth which has, in turn, helped to prevent currency appreciation and safeguarded the competitiveness of the export sector; the reduction of interest rate volatility; a higher credibility of the Chilean government as an issuer of international debt, which has led to a reduction in the sovereign risk premium it has to pay; improved access to foreign financing during negative external shocks and less contagion from international crises; the reduction of foreign financing requirements; and the facilitation of long-term planning of social policies as financial sustainability is ensured.

By way of conclusion, Guajardo pointed out that Chile's institutional strength and the strong political consensus regarding the lessons learned from the country's history are the key factors contributing to its successful development performance. In his view, the remaining challenges include the sectoral and regional disparities in productivity (mostly between mining and non-mining activities) which aggravate income disparities and exacerbate existing inequalities in the country, as well as the challenge of further increasing the diversification and competitiveness of the Chilean economy.

Discussion

This session's discussion was chaired by Shahra Razavi, with Thorvaldur Gylfason and Manuel Riesco as discussants. Gylfason started his comments on the presentation by Mehlum by acknowledging that Norway had indeed been one of the poorest countries in Europe and that natural resources had helped project the country to the top of the Human Development Index ranking. However, he noted, this development was not unique to Norway: its neighbours, Denmark, Finland, Iceland and Sweden, also moved from the bottom of the heap in Europe around 1900 to close to the top in 2000, despite benefiting to varying degrees from natural resource wealth. He posited that human capital accumulation was the primary force behind Norway's economic transformation.

According to Gylfason, Norway presents some symptoms of Dutch disease, such as the stagnant ratio of exports of goods and services to GDP since oil became the main export commodity, the absence of high-tech companies, and (perhaps) government reticence to undertake reforms in the public sector (in health and education in particular). Gylfason agreed with the authors' assessment of the reasons for the success of the Norwegian oil sector, noting that the most important factors were the definition of oil and gas as common property, the government's absorption of approximately 80 percent of the resource rent over time, the wisdom of writing "preventive legislation" and ethical principles in the beginning to guide the use of the resources in the future, the consensus among major political parties to shield the economy from an excessive influx of oil money, and the transfer of the management of the oil fund from the finance ministry to the newly independent central bank. Gylfason concluded his comments with the question of why Norway had not been able to be equally successful in the management of its fishery industry.

In his comments, the second discussant, Manuel Riesco, argued that from a developmental perspective, there was a darker side to Chile's spectacular mining boom Guajardo had emphasized in his presentation. Among the negative aspects, Riesco cited the privatization of most of the rent related to mineral extraction due to ill-conceived tax policies, the appropriation of mineral rents by foreign companies, and distortions in resource allocation as a result of incentives provided to mineral investments, which harm the economy and state revenue in particular. In support of his arguments, he provided a detailed analysis of the participation of private mining companies in the sector, and their performance in terms of company profits and contributions toward tax revenues. His calculations were based on a comparison between the state-owned company CODELCO and the only private company for which financial balance sheets were publicly available, Escondida. Whereas the state holding CODELCO produced 90 per cent of copper until 1989, private companies now account for 70 per cent of Chilean copper production. Notwithstanding,

Riesco explained that public opinion in Chile had consistently and overwhelmingly opposed suggestions to privatize CODELCO and, to the contrary, favoured higher tax contributions from private mining companies. A first move in the right direction had been achieved through the implementation of the special tax on mining, which had already produced over $1 billion[3] in addition to regular income taxes paid by the private mining sector. However, according to Riesco, these amounts were still far from adequate if account is taken of the huge profits earned by private mining companies between 2005 and 2007. If the private companies paid the same proportion of taxes as CODELCO, relative to their respective shares in copper production, this would allow the Chilean state to raise social expenditures by more than two-thirds. Riesco therefore advocated strongly for retaining and maximizing Chilean mineral rents for the social development of the country.

In the plenary discussion that followed, one participant asked how the Norwegian response to Dutch disease—creating a highly competitive oil sector with technological spillovers to other sectors, and solving the employment problem through expansion of the social service sector—was replicable in developing countries. Another participant wondered how institutional capacity in Norway could be explained historically; in particular, why had Norway placed such great emphasis on state management of the oil sector, and continued to do so over time, despite the increasing popularity of market-led approaches. Norway's position outside the European Union was also mentioned; had this sovereignty played a role in the country's success?

A number of questions were raised on the Chilean case study. Had specific policies prompted the diversification of the economy? With regard to the successful management of Dutch disease, several additional tools like capital controls, the crawling peg exchange rate (periodic devaluations) and capital exports by pension funds were mentioned. Another participant asked for further details on one negative aspect of the Chilean model, income inequality, and another inquired about the relationship between mining and the political regime in Chile. Finally, the importance of geopolitics in determining governments' room for manoeuvre in the management of natural resources was mentioned. According to one participant, domestic policy space seems to have increased since the end of the Cold War.

In his response to the discussant and the plenary, Mehlum explained that oil revenue had indeed been an important contribution to national income in Norway, but it had also resulted in a rise in the cost of living in the country. However, he argued that certain changes in relative prices and corresponding structural shifts come naturally with foreign exchange funding and do not represent symptoms of Dutch disease. One challenge was to prepare for future times when oil production and revenues would surely decrease (in this context, he was worried by the dramatic decline in the number of students choosing the sciences in school and university).

With regard to Norway's position outside the European Union, Mehlum suggested that due to the different nature of business cycles in Norway as compared to most European countries it would be difficult to join a common currency. An additional reason to remain outside the EU was the political weight of farmers, who receive important subsidies funded by oil revenues. As to the government role in the oil sector, Mehlum said that strategic issues probably played a role. Norway was a reliable ally of the United States during the Cold War. When the Norwegian government gradually expanded its role vis-à-vis the private multinationals that were participating in oil exploration, this was not criticized by the United States despite the complaints of the oil multinationals. Finally, Mehlum affirmed the importance of the social policy dimension of the Norwegian model in which social services and social policy are extensive, with positive effects on the participation of women in the labour market.

With regard to the discussion on the Chilean experience, Guajardo argued that the diversification in the economy could be explained, at least in part, by the policy change in the late 1970s toward export-orientation and world markets. Macroeconomic stability was maintained throughout the democratic transition in order to strengthen the credibility of the new regime, the importance of which was one of the key lessons learned during previous periods of instability. On the question of income distribution, Guajardo explained that the problem of inequality in Chile was complex and deeply

[3] All $ figures refer to US dollars.

entrenched since colonial times when assets were concentrated among a small number of elites. The situation had deteriorated during the Pinochet regime, as redistributive measures were missing and social protection was insufficient. To increase social mobility in the future, he posited, education could play an important role.

With regard to the contribution of mining and mining companies to national development, he emphasized that frameworks should be adjusted in a flexible manner to changing political and economic conditions. The fact that commodity markets experienced huge profit increases was not an isolated phenomenon in the world. One problem was that mining companies did not have price agreements with countries that would allow governments to capture more revenue when prices increase. In his concluding remarks, Guajardo reminded participants of the fact that before rents can be captured, they have to be created, which was a risky business as only 1 per cent of investments actually end up in commercial production. He therefore called for a balanced approach, between avoiding rent seeking and laying the ground for a competitive mining industry.

Session 4: Overview Country Studies: Indonesia and Nigeria

This session focused on two additional country case studies, Indonesia and Nigeria, again highlighting the numerous challenges of and approaches to managing mineral rents in the developing world. Whereas conventional wisdom usually declares Indonesia a success story and Nigeria an example of failure, the presenters' more nuanced analysis drew out lessons from each case. In particular, they explained, countries perform differently in different time periods. In both Indonesia and Nigeria, politics and political change played an important role but, as pointed out in the discussion of Chile and Norway, the institutional and macroeconomic contexts are equally influential in the management of minerals and ultimately affect development outcomes.

William Ascher began his presentation on "Mineral Wealth, Development and Social Policy in Indonesia" by outlining the main research questions he had pursued in his paper. In seeking to establish a clear link between mineral exploitation and social services, he sought to identify where the flow of resource revenues may be drained away from social services. On the other hand, he drew attention to the fact that Indonesia had quite successfully managed the transition from a low-income economy that was highly dependent on minerals to a lower middle income country and being a net oil importer. This transition bears important lessons for other oil-exporting countries that are likely to face a similar evolution in the future.

According to Ascher, the main objective of social policy is to maximize the use of social services through ample public and private supply of high-quality services that are affordable to the poor, and through the provision of incentives to encourage service usage. Mineral rents could shape the use of social services through many channels. Direct channels may include the use of mineral revenues to finance central or subnational government programmes and transfers, while indirect channels refer to the effects of mineral rents on overall economic growth and income distribution. The latter determines household income and the ability of households to contribute to social insurance or to purchase social services through the market.

Ascher then went on to situate Indonesia as a past and present producer of hydrocarbons and hard minerals, pointing out that the country had never been wealthy in subsoil assets in per capita terms compared to other nations. However, particularly in the past, Indonesia was a significant oil exporter and also had a significant budgetary dependence on oil revenues. Similar to countries like Mexico or Nigeria, declining domestic production levels intersected with rising domestic consumption, turning Indonesia more recently into a net oil importer.

Ascher further explained that Indonesia, Mexico and Nigeria, besides being populous developing nations, also share similar policy histories and outcomes: (i) large, vertically integrated state oil and gas companies with retail monopolies; (ii) requirements for international companies to enter into partnerships with state companies; (iii) serious problems of inefficiency and corruption; (iv) disincentives for foreign investment due to both government policies and periods of political

instability; (v) efforts to privatize state oil and gas companies; and (vi) periods of drastically low domestic fuel prices, countered by efforts to readjust prices to a more sustainable level.

What stands out in the case of Indonesia is that generally sound economic management has kept the country on a path that has maintained agricultural production and simultaneously expanded a competitive manufacturing sector, thereby decreasing dependence on raw material exports. In this sense, Ascher claimed, the resource curse could be avoided. Despite its massive natural resource wealth, the country's economy grew strongly during the

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1970s and 1980s. At that time, Indonesia was dependent on oil and gas exports, which in 1980 represented 70 per cent of government revenue. Yet, the rise in manufacturing and a strong domestic tax effort have since reduced the dependence on oil and gas revenues to the range of 20 to 25 per cent of fiscal receipts, and the net contribution of foreign exchange from oil and gas is minimal.

A significant proportion of the revenue from oil and gas captured during the post-1975 boom was channeled into agriculture, infrastructure and social services. During the oil boom of the 1970s, 20 per cent of government investment expenditure went into agriculture, compared with 2 per cent in Nigeria. Indonesia also avoided Dutch disease by devaluing the currency when oil prices were particularly high, protecting domestic production from cheap imports and maintaining the export potential of the national economy. The Indonesian government also contained inflation and consumption by investing a significant proportion of the windfall revenues abroad. The impressive domestic savings rate of 30 per cent attained by the country by 1980 has been maintained.

Ascher also observed that governance, though still marked by authoritarian practices, has improved in terms of institutional capacity. Even though the institutions related to oil exploitation have traditionally been weak, according to Ascher, the country has long benefited from strong institutions in the central management of economic policy, finance and planning. Moreover, the Indonesian government did not succumb to the temptation of imposing heavy tariffs or other trade restrictions to protect inefficient domestic industries. And in the late 1990s after the East Asian crisis, it pursued serious efforts to reduce domestic subsidies.

Regarding the country's social development, Ascher mentioned that Indonesia's health indicators have lagged behind other countries in the region, even taking into account their relative wealth. This is due mainly to lagging vaccination policies and understaffing in the health sector. In education, Indonesia has been successful in enrolling elementary school children; however, this has not been the case with secondary education. The governmental efforts to escalate education levels have not been backed by corresponding budgetary commitments. In terms of poverty reduction, Indonesia reduced the share of people living on less than one dollar a day from 17.4 per cent in 1993 to 7.5 per cent in 2002. Since 2006/2007, positive progress can be observed in public spending on health and education.

In the post-Suharto era (post-1998), one of the most distinctive strategies to channel resource wealth to social services has been decentralization. Large portions of centrally collected fiscal resources and social services responsibilities have been transferred directly to the district level. The rationale behind this was as political (to undermine the influence of former Suharto adherents and to avoid corruption) as it was economic. With decentralization a new social policy instrument, cash transfers to poor households, has been introduced, partly substituting for the former fuel subsidies, and Ascher held that cash transfers constituted an important advance over the earlier approach. In 2005, unconditional cash transfers were paid to 19 million poor households, and allowed domestic fuel prices to double

without major disturbances. More recently, these programmes have been expanded and transformed into conditional cash transfers with the encouragement of the Asian Development Bank and the World Bank. The new conditional cash transfers are modelled after similar programmes in Latin America and make benefits conditional on utilization of basic health and educational services.

Finally, Ascher identified various obstacles to converting hydrocarbon wealth into positive social outcomes and concluded by stressing the need to overcome leakages in channelling mineral resources into development, to improve quality and access of social services, and to improve the hydrocarbon pricing policy as well as the timing of resource extraction. Indonesia's impressive development under the corrupt and authoritarian Suharto regime demonstrated that good macroeconomic policies can indeed make up for large inefficiencies at the micro level.

'Jìmí Adésínà followed with a presentation on "Mineral Rents and Social Development in Nigeria". He emphasized the significant role social policy had played in efforts to build trust and national cohesion in the post–civil war era in the 1970s. A significant dimension of that was financed by earnings from natural resources—agriculture and hydrocarbons. Policies around education and health have dominated in the Nigerian context, illustrating the prominence of the productive and redistributive dimensions of social policy in the country. Rather than an undifferentiated picture of failure, as the orthodox literature on the resource curse would have predicted, Adésínà described a more complex sequence of temporal and regional variations in Nigeria's post-colonial experience with natural resource wealth.

According to Adésínà, regression analysis reveals little in cases where local contexts, historical patterns of social relations, politics and economic management need to be taken into account. Nigeria went through different periods of development, with two episodes of major success on both the economic and social policy fronts. The first was linked to the launch of the First Development Plan (1955–1960) by the government of Western Nigeria, which focused on human capital, infrastructure, support for agricultural production and diversification of the economy. The period was characterized by a clear normative commitment to social development, fiscal prudence and high-quality public administration. Following the experience of a traumatic civil war (1967–1970), in 1970 a Second National Development Plan (1970–1974) was designed. Reconstruction efforts in the decade of the 1970s went beyond rebuilding damaged infrastructure: public policy was seen as an effective instrument to "heal" the national wound and to develop a sense of national identity and cohesion. The launch of the universal primary education programme in 1976 was made possible by increased resources from mineral wealth. Additionally, university education became tuition-free and overall spending on education reached 6 per cent of GDP in 1980. There was a similar expansion in the field of health care.

According to Adésínà, the Nigerian example illustrated the social returns of these investments in terms of positive impact on social and political stability, trust within the polity, investment and growth. Mineral rents became increasingly important as a financial base for these policies.

Adésínà went on to explain how the significance of hydrocarbon-based earning was most clearly reflected in the Third Development Plan (1975-1980). In response to the global oil price hike at that time, revenues increased sevenfold. The implications for economic development planning and social policy financing were quite significant. Nonetheless, he remarked, the issues around development outcomes are much more complex than a simple reading from the rentier state or the resource curse literature would suggest.

From the 1980s on, Nigeria has been classified as a rentier state; however, it is important to distinguish between a pre- and a post-1985 period, with the period from 1980 to 1985 being a time of policy transition. A stabilization programme that was launched in 1982 focused on retrenchment of spending, credit and foreign exchange rationing, and a liberalization programme which would supposedly lift Nigeria out of mineral rent dependence. Interestingly, more than 25 years later, the economy still depends on mineral rents which account for 90 per cent of export earnings. After 1985, Nigeria

witnessed a deepening of the neoliberal reform agenda that, according to Adésínà, not only failed to fix the economic problems of the country, but also contributed to a process of institutional decay and the erosion of social trust and cohesion.

Even though corruption was not a new problem in Nigeria, windfalls were grossly mismanaged during the period when mineral-based revenues rose significantly. The subsequent collapse in oil prices and revenue tipped the economy into a grave crisis. The broad framework of equitable access to publicly funded education and related social provisioning enforced in the 1970s weakened in the period of stabilization and effectively ended under the liberalization regime. First, severe cuts

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in public spending after 1982 weakened service delivery in public health and education facilities. One example is spending on education, which went from 6 per cent of GDP in 1980 to 0.65 per cent in 1995. Then, the weakening quality of service was used as an argument against public sector provision, paving the way for a shift to the private sector. As a result, human development indicators deteriorated and poverty, measured according to national poverty lines, rose from 28 per cent in 1980 to 66 per cent in 1996.

According to Adésínà, the challenge of dependence on natural resources is not an insurmountable condition for a resource-rich country. The challenge has always been to have the necessary policy leadership to be able to break out of the natural resource enclave. Natural resource wealth can contribute positively to financing economic and social development and to diversifying the economy. In the case of Nigeria, he emphasized that the little that was achieved in this regard between 1950 and 1970, and then between 1970 and 1980, indicates that even more could have been achieved.

The lesson to be drawn out of the Nigerian case from the early 1980s is that prudent management of petroleum revenue is fundamental in protecting the economy and the society from the external shocks that are caused by widely fluctuating oil prices. The collapse in social cohesion and trust, and the state of anarchy that prevails in some parts of Nigeria, are clear examples of the consequences of ideologically driven policy orientations that fail to think of policy in its diverse forms: economic, social and political. Adésínà concluded his intervention by adding that social policy and an active state have significant roles to play in shaping the future of Nigeria. In particular, the transformative role of social policy, not only relating to protection and reproduction but also to production and redistribution, will be fundamental in the process of economic and social reconstruction that the country is undertaking. Indeed, he posited, in addressing the critical issues of poverty and inequality, social and environmental justice cannot be achieved through the market logic or through targeting; instead, they demand broad-based universal access to social services and income protection complemented by special efforts to respond to the demands of specific groups.

Discussion

In his comments on the Indonesian case study, Terence Gomez focused on three main points raised in the paper: decentralization, reform of the bureaucracy and neoliberal reforms. Gomez said that Indonesia was an interesting case study of a country in political transition, offering the possibility of analysing social policies under both authoritarian rule and the newly democratized system. With regard to decentralization, he remarked that the political restructuring, which largely bypassed province governors to reach local districts, directly empowered local policy makers to an extent that had been unimaginable under the Suharto regime. In this sense, Gomez pointed out, the paper presented an extensive criticism of this process; however, it did not examine how local governance had changed through the reforms. Gomez suggested that an interesting angle to the inquiry would be to study local councils and their differing performance in terms of delivering social services, as well as the mechanisms of resource allocation, under Suharto and post-Suharto regimes. In terms of policy recommendations, he suggested improving decentralization rather than recentralization.

With regard to reform of the bureaucracy and the issue of corruption, Gomez argued that, throughout the reform process, problems of administrative capacity and service delivery had not been addressed. Problems with delivering social services under an ineffective local bureaucratic structure had led to institutional voids; for Gomez, the question was whether privatization or greater participation of the private sector, as the paper suggests, is an appropriate solution. The capture of institutional voids by business interests might lead to new patron-client links and corruption, for example, which leads to the conclusion that local governments have to be protected from rent seekers. Concerning the third point on neoliberal reform, Gomez raised doubts that a retreat of the state from the oil and gas sector would be beneficial. Poor performance of agencies like the national oil company, Pertamina, in Indonesia could be explained by the lack of reform of the bureaucracy and state-owned enterprises; this should be a priority before allowing more foreign firms to participate in the sector. By way of conclusion, Gomez suggested that the public oil company, Petronas, in Malaysia might provide lessons for future reform of Pertamina. Petronas, although involved in numerous scandals and bailouts in the past, is now a thriving company.

Cyril Obi was the discussant for the Nigeria case study. He acknowledged the substantive analysis the paper makes on a very complicated issue and the sound critique of the resource curse literature that Adésínà presented. With regard to the discussion on rentier or oil states, he wondered what the double role of the state—as gatekeeper/rent-seeker and as producer—meant for its allocative capacity, as well as for power relations between the state and private producers in the sector. How are mineral rents allocated and where does social policy come into play? Do allocation rules change if the state is directly involved in production? What is the capacity of the state to regulate the oil industry?

One of the main topics addressed in the Nigerian case study was the effect of the International Monetary Fund (IMF) structural adjustment programme. Obi mentioned how the adjustment programme started in the oil industry, with the removal of subsidies. He mentioned that it would be useful to know how this affected social policies and redistribution. Did it make things better or worse? With regard to Nigerian politics, he queried the reason for the policy shift away from the social projects and the role de-indigenization and de-nationalization played in this process. He encouraged the author to link questions of mineral rent management with civil society and the activities of multinational companies. Oil corporations often engaged in community projects and building social infrastructure, and it would be useful to know what implications this had for the state.

Another point that Obi regarded as important was the specific conditions under which some states have been more successful when diversifying their economies than others. For example, Indonesia was able to develop its manufacturing industry while simultaneously earning the majority of state revenue from natural resource rents, while Nigeria was not.

In the following plenary discussion, participants referred to the questions of state governance and private sector performance. In many countries, the role of the state had been expanded after the private sector had failed to engage in productive investment, often because the macroeconomic environment did not offer enough incentives to do so. What we find in the case of Indonesia and Nigeria is a developmental state, but with high levels of corruption. One participant wondered why Indonesia had been more successful than other countries. He suggested that one possible answer could be the fact that Indonesia was characterized by a stable long-term regime, whereas in Nigeria frequent governmental changes seem to have been disruptive. An alternative explanation could be the breakdown of the political settlement that had existed in Nigeria up to 1979. Finally, it was noted that decentralization of functions in Indonesia had been accompanied by decentralization of funding mechanisms as well. The Latin American experience had shown that, although social services had been transferred to lower levels in the process of decentralization, the corresponding transfer of funding mechanisms had often been insufficient.

In his response, Ascher referred to the difficulties of getting comparative information about the performance of local councils in Indonesia, as the situation was in constant flux. However, a good assessment about the outcomes of the decentralization process was indeed important in order to evaluate recent social policy initiatives that seemed to indicate a process of recentralization. With regard to Pertamina, he expressed

doubts about the possibilities of reforming it according to the Malaysian experience—in his view, Malaysia had a clear advantage in terms of governance capacity. He then touched upon an issue that had been raised by Obi with regard to the Nigerian case: the provision of social services by oil multinationals. He would characterize this as a leakage, he argued, because oil companies did not have a comparative advantage in social service provisioning and mostly do it in an inefficient way.

Adésínà ended the discussion by emphasizing the importance of governments that manage to smooth tensions in ethnically and socially diverse contexts, especially in post-conflict situations. In the case of Nigeria, the First Republic had been more successful in this sense. Social policy played a key role in this process, whereas the subsequent dismantling of these programmes led to institutional decay and hitherto unknown levels of corruption.

Concluding Remarks

In the final session, research coordinator Katja Hujo referred again to the challenges of analysing social policy in a context of mineral-rich countries. Thus far, she pointed out, most of the existing literature had focused on the study of the economic and political implications of rents from natural resources, in particular with respect to macroeconomic stability and democratic governance. The role that social policy has played and could play in harnessing the use of these rents for development has been mostly ignored. She held that there is a clear need for more in-depth empirical work on the linkages between the economic, social and political dimensions of a development path that is strongly shaped by a primary sector like mining. She hoped that the papers discussed at the workshop would feed into an analytical framework that could be applied to substantive country case studies. Research looking at the different dimensions and policy responses of mineral-led development in selected countries would allow a more complex picture of this specific growth path to be captured. Such a picture would be embedded in a particular historical and geographical context, but it would also allow overarching challenges and policy lessons beyond each case to be identified.

One workshop participant emphasized that the development dynamics in mineral-rich countries are extremely important. Countries go through different phases after the discovery of minerals. Often, decisions taken in the first five years, or lessons learned during early periods of mineral-led growth, tend to shape the future for decades to come, as the examples of Norway and Chile have shown. In Norway, policies for managing oil rents are guided by principles (the so-called commandments) that were established early on and have received broad support since then. Norwegian citizens support public management of oil resources because of widespread and strong trust in state capacity and accountability, based on an effective tax system and state responsibility for social services and protection. Once we move away from developed countries like Norway, however, it is crucial to incorporate issues of consolidation of democracy and state building into the analysis, as one participant remarked. Many mineral-rich countries fare well on human development indicators and invest in education and health, but they often perform poorly in terms of human rights or equity. Social policy after the World Summit for Social Development held in Copenhagen in 1995 has been explicitly related to social inclusion, social relations and gender equality. Such an approach differs from the so-called productivist social policies that focus on human capital investments or are centred on those groups that are closest to the productive system, as in the case of East Asia.

Several participants noted that it was important to include the external environment and external actors in the analysis, as they influence policy decisions on mineral wealth and the overall economy, especially in poorer countries. Southern countries are a constant laboratory of economic and social policies—reforms are often based on international policy trends, as the example of cash transfers in Indonesia demonstrates. Finally, it was suggested, analysis of the role of multinational corporations, foreign direct investment and public-private partnerships for mineral development would also make a valuable contribution to future inquiry.

Agenda

Thursday, 24 April 2008

Opening Session

9.30–9.45 *Welcome and Introduction to UNRISD*, Thandika Mkandawire

9.45–10.00 *Social Policy in Mineral-Rich Countries—What Are the Issues?* Katja Hujo

10.00–10.30 Discussion

10.30–10.50 Break

Session 1: Economic Challenges and Potential in Mineral-Rich Countries

Chair—Janvier Nkurunziza

10.50–11.50 Presentation of the Thematic Papers

- *Economic Policy in Mineral-Rich Countries*—Samuel Asfaha
- *Development and Growth in Mineral-Rich Countries*—Thorvaldur Gylfason

10.00 – 10.30 Discussants—Katja Hujo and Albert Berry

12.10–13.00 Plenary Discussion

13.00–14.30 Lunch break

Session 2: State Capacity and Social Policies in Mineral-Rich Countries

Chair—Yusuf Bangura

14.30–15.30 Presentation of the Thematic Papers

- *Institutional Change and Developmental State Capacity in Mineral-Rich Countries*—Evelyn Dietsche
- *Social Policy and State Revenues in Mineral-Rich Countries*—Leonith Hinojosa-Valencia

15.30–15.50 Discussants—Halvor Mehlum and Anthony Hall

15.50–16.10 Break

16.10–17.00 Plenary Discussion

Friday, 25 April 2008

Session 3: Overview Country Studies: Norway and Chile

Chair–Shahra Razavi

9.30–10.30 Presentation of Country Papers

- *Mineral Rents and Social Development in Norway*—Halvor Mehlum
- *Development in Chile*—Juan Carlos Guajardo

10.00–10.30 Discussants—Thorvaludur Gylfason and Manuel Riesco

10.50–11.10 Break

11.10–12.00 Plenary Discussion

12.00–13.30 Lunch break

Session 4: Overview Country Studies: Indonesia and Nigeria

Chair—Samuel Asfaha

13.30–14.30 Presentation of Country Papers

- *Mineral Wealth, Development and Social Policy in Indonesia*—William Ascher
- *Mineral Rents and Social Development in Nigeria*—'Jìmí O. Adésínà

14.30–14.50 Discussants—Terence Gomez and Cyril Obi

14.50–15.40 Plenary Discussion

10.50–11.10 Break

Closing Session

16.00–16.20 Wrap Up and Outlook—Katja Hujo

16.20–17.00 Plenary Discussion

Participants

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The **United Nations Research Institute for Social Development (UNRISD)** is an autonomous agency engaging in multidisciplinary research on the social dimensions of contemporary problems affecting development. Its work is guided by the conviction that, for effective development policies to be formulated, an understanding of the social and political context is crucial. The Institute attempts to provide governments, development agencies, grassroots organizations and scholars with a better understanding of how development policies and processes of economic, social and environmental change affect different social groups. Working through an extensive network of national research centres, UNRISD aims to promote original research and strengthen research capacity in developing countries.

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This **UNRISD Conference News** was written by Katja Hujo, with assistance from Elena Gaia, Leonardo Lara and Christy Campbell.

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