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# Blood Oil: Tyrants, Violence and the Rules that Run the World

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*Blood Oil: Tyrants, Violence and the Rules that Run the World* by Leif Wenar, Oxford University Press, 2016, lii + 494 pages.

The discovery of natural resources has been a mixed blessing for many countries. Despite the promises of new riches, economic performance has often deteriorated whilst corruption and rent seeking take off. This has been called the "resource curse". We first discuss the traditional economic and political determinants of the curse before moving on to discuss the ethical and legal aspects highlighted in the book *Blood Oil* by Leif Wenar.

## 1. Economic and political drivers of the resource curse

A common account of the resource curse runs as follows. Countries with a boom in natural resources do not always experience it as a blessing. Their growth rates often decline and in some cases even become negative. Poverty as well as the share of income and wealth going to the very rich often increase. Furthermore, the non-resource export sectors (mainly industry) often go into decline as the real exchange rate appreciates to cope with the additional resource-driven demand. Conversely, the non-traded sectors (such as government and construction) boom with high wages as labour and capital are sucked into the non-traded sectors from the non-resource traded sectors. This need not be a problem, but these non-resource traded sectors are typically in urban areas and are the engines of long-term growth, feeding on learning-by-doing effects and the conglomeration advantages that cities offer. As a result, a temporary natural resource boom will lead to a temporary decline in growth rates and permanent fall in national income.

A related reason why countries fare so badly when they discover natural resources is that natural resource revenue is not only a very high percentage of GDP, exports and the government budget for many developing countries, but it is also highly volatile. This makes planning difficult as firms and households find it difficult to assess changes in relative prices. Furthermore, firms are more often liquidity constrained, which means that they cannot fund innovation. Thus, growth is stunted, especially in countries with badly developed financial systems. Ideally, countries could use financial derivatives to hedge their natural resource revenue (as Mexico does), but such markets are very thin and costly, so this strategy is often not feasible or practical. Furthermore, hedging is politically risky. For example, if commodity prices do not collapse, voters may well ask why has the money been wasted on financial derivatives rather than spent on education or health programmes for the people.

An additional explanation for the resource curse is based on warped political incentives. Much of the public revenue that has been generated by natural resource wealth is squandered by short-sighted politicians who prefer to see the money spent whilst in office rather than after they are gone. Examples exist where countries used their natural resource wealth as collateral to over-borrow on international capital markets when they can sell their produce on world commodity markets at a high price, only to get stuck when commodity prices collapse. Other examples exist of countries over-investing in partisan projects rather than in more neutral growth-enhancing projects. The return on these ‘white elephant’ investments has often been low and many projects are under-utilised and remain incomplete.

The empirical evidence confirms these insights and suggests that a high share of natural resource exports damages growth prospects, especially in countries that are landlocked or ethnically diverse, have restrictions on the current account but unfettered capital flows, and have poor institutions, rule of law and financial development (for surveys, see van der Ploeg (2011), Deacon (2011) and Cust and Poelhekke (2015)). The curse is also stronger for onshore than for offshore natural resource wealth, since onshore wells and fields are easier to attack and steal from. The curse is also much stronger for resources with highly concentrated sources of value and that are capital-intensive as is the case for oil, gems and certain metals and less so for coffee and rice, say. The empirical evidence suggests that the quintessence of the natural resource curse is the notorious volatility, not the level of resource revenue. This is notwithstanding that there is local impact evidence that suggests that opening a mine leads to additional income for those living closer to the mine. At the macro level, countries tend to fare worse. The natural resource curse can be turned into a blessing provided countries manage to improve their institutions and fight corruption and clientele politics, but that is easier said than done as has been discussed by Venables (2016). So what can and should be done?

The standard advice of economists and supranational institutions such as the International Monetary Fund has been to follow what Norway has done: save the resource revenue in an intergenerational sovereign wealth fund and withdraw from this fund once the revenue stream has dried up. If one follows the permanent income rule, one should borrow ahead of the pumping and thus smooth consumption and spread the wealth across the different generations. Norway’s bird in the hand rule is more conservative and does not allow using under the ground resource wealth as collateral to borrow. This rule therefore leads to more volatility than the permanent income rule. The problem with both rules, however, is that they are great in theory but bad in practice. The few developing countries that have set up a fund (sometimes including a liquidity fund to keep precautionary buffers to dip into when commodity prices fall) have seen it collapse or raided by political rivals. The problem is that sovereign wealth funds contains assets that are highly liquid and non-partisan, and are thus very easy to raid when a new populist government enters office even there are constitutional safeguards in place. This is why politicians of resource rich developing countries prefer to invest their wealth in irreversible, partisan projects, which cannot be easily reversed by future political rivals. Needless to say, such politically opportune policies do not harness the resource wealth optimally for growth and development.

## 2. Wenar's ethical and legal contributions

The foregoing, common account underplays some fundamental ethical and political issues including the role of the international legal order in sustaining authoritarianism and civil conflict related to natural resource exploration and exploitation. These have hitherto received insufficient attention, as is forcefully and cogently argued in Wenar's excellent *Blood Oil*. This book goes to the heart of the issue: today (as throughout history) whoever controls natural resource territories by force or otherwise can command huge rents, and therefore their rulers use repression to stay in government and hold on to these rents whilst rebels and others use armed struggle to gain control of office and to get control of those rents. Economists such as Hirschleifer (1991) and Skaperdas (1992) have argued that the intensity of fighting increases in the size of the rents but decreases in the opportunity cost of labour, which is the wage that could be earned if rebels do not fight. Wenar's point is that authoritarian regimes use the revenue stream to divide and rule through coercion and/or clientelism, although they could also initiate a war with a foreign country or fund ideological campaigns to improve their grip on office. (It follows that when commodity prices crash, as they have done in recent years, many of these regimes find it harder to hold on to office.) Crucial for Wenar's view of the politics of resource-fuelled authoritarianism is that the power exerted to keep control is mostly unaccountable and that the countries they rule are not free.

Before one gets to the key messages of this important book, it is crucial to understand the legalities of the problem, which are, sadly, overlooked in most economic analyses of resource-rich countries. A reason for the unaccountability of power is that billions of consumers and companies benefit from cheap natural resources by buying cheap products from Western and also from Chinese and Indian companies without asking whether it is legitimate for the authoritarian tyrants or their cronies to sell off the natural resource wealth that legally and morally belongs to the people of their country. In other words: we are complicit in keeping these nasty rulers in office. In this context, Wenar rightly stresses the role of the rule of effectiveness, which is more poignantly summarised by the principle 'Might Makes Right.' This principle reflects the immoral notion that once coercive rulers have sold their country's natural resources on the world market, the importers from abroad become the legal owners. This principle has its roots in the 17th century Westphalian international system and puts the world's consumers of natural resources into legal business relationships with violent and repressive autocrats abroad. To make matters worse from a moral point of view, 'Might Makes Right' is not forced upon rich importing countries by international law or treaties. Still, each importing state chooses to uphold this principle even though they could have chosen not to do so. It is difficult to depart from this status quo, since it is costly for individual countries to break the international norm.

Resource-fuelled authoritarian regimes have always posed substantial threats to the West. The West has never tackled the legal roots of the unaccountable power of resource-cursed states.

Instead, it has chosen to impose sanctions, undertake military actions or form alliances with authoritarian regimes. Such actions have rarely achieved their aims or contributed to stability, but have imposed huge costs on the people of resource-cursed states. These people therefore only not suffer from being prevented from sharing and benefiting from natural resource windfalls, but also incur the costs of the West's attempts to grapple with their unaccountable rulers.

Wenar therefore argues that the only credible source of accountability over natural resources is to ensure that the citizenry is empowered to be an effective countervailing power to leaders who have every incentive to lie about what they do and have done with the nation's natural resources. This seems to echo the longstanding pleas of George Soros for an open society and support the goals of the Earned Income Transparency Initiative and the Natural Resource Charter. Wenar also demands that all peoples should, for their own ends, freely dispose of their natural resource wealth and resources in line with Article 1 of both of the Human Right Conventions. This popular resource sovereignty is in line with the argument used in international summits and treaties that the natural resource wealth belongs to the people themselves, and thus does not belong to illegitimate, coercive rulers. This could lead to the conclusion that resource wealth should be handed out to the people in the form of citizen dividends as is done in Alaska and be taken out of control of coercive rulers.

Wenar convincingly argues that the burden of making progress towards this aim lies with the West and therefore it is important to promote clean trade policies which make imports from authoritarian natural resources illegitimate (cf. the Kimberley agreement forbidding trade in blood diamonds) and which impose duties on imports of countries that have bought stolen natural resources. Wenar argues that such policies put existing social and ethical norms about justice into law and that they are feasible and operate with the limitations of today's international system. Furthermore, it might be hoped that Western states that implement such clean trade policies to their own economic disadvantage will gradually gain the much needed trust of the people of resource cursed states. Here, Wenar might be a little too optimistic. For it is not clear that it is feasible for Western countries to impose tariffs on, say, Chinese goods in proportion to their use of Sudanese oil. More important, such clean trade policies might, like the sanctions imposed on Russia today and on South Africa in the past, hurt the people of those countries more than their corrupt rulers.

Wenar points out that slave trade, colonial rule, apartheid, ethnic cleansing, genocide and trade in blood diamonds were in the past all legitimised by Westphalian norms, but all of these unethical practices have now been abolished in law. This provides Wenar grounds for optimism that one day in the not-too-distant future the West will no longer be complicit in keeping resource tyrants in power in order to keep on benefiting from stolen natural resources. Wenar's mix of ethical and legal arguments might also be applied to combating what Higgins (2015) has called ecocide: the extensive damage to, destruction or loss of ecosystems of a given territory to such an extent that peaceful enjoyment by the inhabitants of that territory is severely diminished. The lawyer Higgins argues that this should be included in the Rome Statute (the treaty establishing he International Criminal Court), and, I submit, many of the suggestions in this book can be worked out for the case of ecocide too. Similarly, Wenar's arguments can also be adapted to fight the international sale of weapons to tyrants and the international trade in cheap products produced by child labour.

In many Western societies, movements criticising the international capitalist system and pushing for corporate social responsibility on all these issues are gaining traction. It is important to point the finger at multinational corporations and make sure that they feel the heavy weight of the law if they whitewash fraudulent monies and trade with resource-rich dictators. It should be easier to tackle a small number of big companies and enforce clean trading laws. Still, consumers can help too, and they are rightly demanding more and better information on companies dealing with corrupt regimes and engaging in unethical practices. Increasingly, savers are voting with their feet and asking their pension funds to stop investing in such companies. Investors are increasingly taking a similar line, starting with the Scandinavian countries. Such bottom-up movements are in line with Wenar's pleas for an empowered citizenry and they complement clean trade policies. Citizens may well take action long before governments finally change the law and forbid these unethical practices.

This provocative and authoritative book is very well written and deserves the highest recommendation. It shows that philosophy and legal arguments lead to a deeper understanding of the ethical absurdities governing our international political, legal and trading arrangements. If political leaders were to read this book and take action, the world would become a safer and fairer place with fewer atrocities. Some may doubt how pragmatic the solutions put forward are, but it has been done before and it can be done again.

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