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Energy wealth and tax reform in Russia and Kazakhstan

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Abstract

Resource-rich states throughout the developing world are prone to rent-seeking, excessive borrowing, wasteful spending, and unbalanced growth as well as states with weak institutions and authoritarian regimes. Are the five energy-rich Soviet successor states necessarily doomed to repeat this experience, often referred to as the "resource curse"? This paper advances and tests the hypothesis that Russia and Kazakhstan are more likely to avoid the "resource curse" than Uzbekistan, Turkmenistan, and Azerbaijan because they privatized their energy sectors. Specifically, we find that privatization offers a potential path out of the "resource curse" when it involves a transfer of ownership to domestic actors. Although Kazakhstan initially appeared to be developing a viable tax regime in response to foreign investors, over the long term Kazakhstan's tax regime has become increasingly volatile and dependent upon these foreign investors. In contrast, domestic oil companies are helping to foster the development of an increasingly viable tax regime in Russia.

Keywords: Resource curse; Taxation; Privatization; Kazakhstan; Russia

Introduction

What has widely become known as the 'resource curse' refers to a particular set of negative political and economic conditions that are prevalent in developing countries rich in natural resources (e.g. Auty, 2001; Gelb, 1988; Karl, 1997; Shafer, 1994)[2]. Economically, states with resource wealth are prone to rent-seeking, excessive borrowing, wasteful spending (often on large public works projects), and unbalanced growth. The negative political conditions can be summarized as weak (or under-institutionalized) states and authoritarian regimes.

An implicit assumption that pervades the literature on the resource curse is that resource wealth is always and necessarily state-owned[3]. Aside from the obvious objection that this is not the case empirically, another problem with this line of reasoning is that it does not make explicit what the hypothesized causal links are between state ownership and the negative economic and political outcomes associated with resource wealth. What is it then, that links state ownership to the excessive spending, unbalanced economic growth, and weak institutions that we see throughout resource rich states in the developing world? If state ownership is largely responsible for generating such outcomes, then might we expect private ownership of natural resources to have the reverse effect?

In other words, does the structure of ownership matter? The energy rich states of the former Soviet Union — the Russian Federation, Azerbaijan, Kazakhstan, Turkmenistan, and Uzbekistan — provide a unique opportunity to explore this question. At one end of the spectrum, Turkmenistan and Uzbekistan maintained full state ownership over their respective oil and gas reserves, and rejected the direct involvement of international actors in

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[1] The authors share equal responsibility for the content and analysis herein. This article is part of a long-term joint project and we have chosen to rotate authorship on the articles we generate.

[2] For an overview and critique of the sectoralist approach, see Davis (1998).

[3] By 'state-owned' we do not mean state ownership of subsurface mineral resources, but rather state ownership and control over mineral deposits and production facilities.

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developing them. At the other end, Kazakhstan completely privatized its energy sector by selling the majority of shares in formerly state-owned oil and gas enterprises to foreign investors. In between these two extremes, the Russian Federation privatized its energy sector to domestic capitalists with only a minimal amount of international involvement, while Azerbaijan maintained full state ownership over its energy reserves and invited foreign companies to assume a direct role in developing them. Are Russia and Kazakhstan, then, more likely to avoid the 'resource curse' than Uzbekistan, Turkmenistan, and Azerbaijan because they privatized their energy sectors? There is good reason to expect that this might be the case. Not only is state ownership a common denominator across the literature on resource rich states, several other relevant bodies of literature — including economic reform and environmental regulation — emphasize the importance of privatization for more efficient economic policies and resource management. Yet, the causal mechanisms have not yet been explored.

We advance this debate by generating several testable hypotheses explicitly linking the structure of ownership over natural resources to the design of an institution that is critical to both economic growth and political liberalization — taxation. A weak (or non-existent) tax regime is viewed in the literature on the resource curse as perhaps the most prevalent negative outcome of resource wealth due to state leaders' myopic thinking and heavy reliance on external (i.e. rather than internal) sources of revenue. The lack of a viable tax regime has also been consistently identified in this literature as impeding broad economic growth and the development of democracy (see e.g. Karl, 1997). Conversely, the development of a viable tax regime is often cited as facilitating transitions to democracy, economic development, and state capacity (see e.g. Bates and Lien, 1985; Levi, 1988).

In sum, our findings show that privatization does indeed offer a potential path out of the 'resource curse', but only if it involves a transfer of ownership to domestic interests. Private owners have had a direct and overall positive influence on the development of taxation in Russia, but not in Kazakhstan. Ironically, although Kazakhstan initially appeared to have a much more viable tax regime due to the direct influence of foreign investors' interests, over the long term it has become increasingly volatile, and Kazakhstan has failed to expand its tax base beyond these foreign investors. Rather, it has become increasingly reliant on them for revenue over time. In contrast, domestic oil companies are helping to foster the development of an increasingly viable tax regime in Russia.

The rest of the paper proceeds as follow. In the next section, we lay out our general hypotheses concerning the effects of ownership structure on the development of taxation regimes. The third section provides empirical data to test these hypotheses in Kazakhstan and Russia. The evidence is based upon extensive interviews carried out in Kazakhstan in Spring 1997, Fall 1999, Spring 2000 and in Russia in Fall 2001. The last section summarizes our findings and highlights their implications.

Ownership structure and taxation

We hypothesize two mechanisms through which the structure of ownership has a direct effect on institutional development:

1. the resource allocation effect (RAE); and
2. the political influence effect (PIE).

The former (RAE) affects *who* the relevant agents are; the latter (PIE) affects *how* these agents exert their influence on subsequent institutional development. In other words, the RAE determines whether new actors are created outside the state, but these actors have different interests and exert political influence through different means. As summarized in Fig. 1, state ownership leads to the concentration of proceeds from the development and export of natural resources and state capture by bureaucrats vested in maintaining the status quo and, most importantly, limiting the political influence of non-state actors. In contrast, private ownership results in the dispersion of resources and the generation of new interests that seek to influence policies and institutions through lobbying from outside the confines of the state.

The resource allocation effect

Ownership over natural resources affects institutional and policy outcomes, first and foremost, because it determines whether the proceeds from the development and export of these resources are concentrated or dispersed.

State ownership leads to the concentration of proceeds within the state apparatus itself. Thus, the direct beneficiary of these proceeds is the state, which gives actors within the state greater discretionary power over how resources are distributed and utilized. In other words, the more concentrated the proceeds, the more likely that the key actors involved in decision-making will themselves be concentrated within the state. This has several implications for elite behavior and institutional development. Without any external oversight, state actors have both a greater incentive and opportunity to strip assets and sell them abroad in the short-term (i.e. steal what they can while they can) rather than invest in long-term economic growth, engage in corruption, and neglect institution-building. In particular, they are likely to ignore the development of a broad-based tax regime that is so intimately tied to state capacity and democratization (see e.g. Levi, 1988; Bates and Lien, 1985).

Private ownership results in the dispersion of proceeds from resource wealth, and hence, the generation of new