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.

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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). 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. 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 mineral resources, but rather state ownership and control over mineral deposits and production facilities.
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...
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