Held Hostage: Arms and Infrastructure
Oil Development in Sudan and Chad

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Introduction

After decades of delay, Sudan began producing oil in 1999, with the revenue hastily channeled into arms purchases to support a drawn-out civil war. The delay was caused by the unsavory reputation of the Sudanese government. Development had to proceed without the sponsorship of a major multinational oil company or assistance of any established international financial institution. In contrast, an oil pipeline is now under construction in Chad and Cameroon, with broad-based international support. This project has been held out as a "model" of development; one that creates jobs, respects human rights, and protects the environment. The Chad-Cameroon pipeline is sponsored chiefly by ExxonMobil and is partially financed by the World Bank. Nonetheless, there is growing unease about the Chad project and the impact it might have on fueling conflict and genocide, as oil revenue has done in Sudan.

Large natural resource projects frequently create significant and abrupt economic rents in countries that do not have an established rule of law. When such windfalls are concentrated in the hands of a few political leaders, it creates immediate demand for enforcement and protection of the status quo. Quite rationally, oil revenue is spent on arms, as a means to enforce control over the resource and to pacify the population. Aside from the potential violation of human rights, preservation of the status quo also calcifies economic progress, condemning the general population to an uncorrectable cycle of poverty and deprivation.

Although the World Bank's plan for Chad and Cameroon was developed under the best of intentions, it may not produce the best of results. The chosen procedure concentrates property rights and associated oil revenue in the hands of the countries' political leaders instead of diversifying ownership and control. Without broad-based ownership rights, there is little incentive for the institutions that facilitate trade to develop and mature, i.e., there is little or no demand for exchange and thus, reduced opportunity for economic development.

Oil Development in Sudan

Two decades ago, Chevron discovered the Heglig oil field in southern Sudan. The company struggled to develop the discovery, but Sudan's political system was in disarray. The Moslem government in North Sudan was in conflict with Christians and Animists in the South and the consequence was a bloody civil war that seemed endless. In order to access the oil, a pipeline of over 1,600 kilometers from Southern Sudan to the Red Sea would have to be built; a pipeline that could easily cost billions of dollars and leave Chevron hostage to the vagaries of an unstable government. Despite a prolific discovery, Chevron abandoned the project. BP picked up where Chevron left off, but in the end, it too concluded that the obstacles were just too great and rights to the development were sold to a small oil company, Arakis.

Talisman, an independent Canadian oil exploration and production company, bought Arakis and formed a partnership with Petronas, the national oil company of Malaysia, the China National Petroleum Company (CNPC), a government-owned company in China, and interests of the Sudanese government to construct the pipeline. The companies, through pre-sale of the crude oil, promissory notes and other ad hoc methods, financed construction. The partners had extraordinary luck and crude oil began flowing just as prices rose in the fall of 1999. As the first cargo of crude left the harbor, however, it passed an inbound ship carrying tanks and other arms to support the Sudanese government's war in the South, and, of course, to protect the pipeline from sabotage.

Sudanese oil production hovers at slightly over 200 thousand barrels per day, frequently at prices above $30 per barrel. The stream, Nile Blend, is of good quality and well situated to move cheaply to Asian refineries. The flow of oil wealth may or may not resolve the conflict; Paul

Salopeck (2003, p. 34) noted that as of April 2002: "Africa's largest country is lurching into its 19th uninterrupted year of warfare—the latest round of strife that has brutalized Sudan, off and on, most of the past half century. More than two million Sudanese are dead." The Government and opposing forces did sign a cease-fire in October 2002, and the facts are that they need each other. The oil—both fields in production and prospects—is in the South, while the government and economy is in the North. The conflict, however, is based on ancient racial and ethnic issues and will not be easily resolved.

Publicly listed companies have bowed to pressure from religious leaders and human rights advocates to blacklist Sudan. As noted, both Chevron and BP withdrew. The latest to retreat is Talisman. There had been extensive complaints to its board of directors and downward pressure on its stock price. In consequence, Talisman sold its Sudanese interests in March 2003 to ONGC Videsh Limited ("OVL"), a subsidiary of India's national oil company (Talisman 2003). Thus, the three principal owners of the Greater Nile Project, and the companies poised to expand production in Sudan, are all government-owned national oil companies, easily insulated from public criticism when they operate in a foreign land.

The Oil Pipeline Project in Chad and Cameroon

Development of the oil pipeline in Chad and Cameroon took a very different path, the polar opposite from development in the Sudan. For decades the Major oil companies have been criticized for their oil infrastructure investments in developing nations. Far too often, royalties, transit fees, etc. have been used to support corrupt regimes or, worse yet, to supply arms and feed civil war, as in Sudan. Instead of economic growth, infrastructure development provoked cultural and ecological destruction. Thus, ExxonMobil and the World Bank strove to do things differently in Chad.[1]

Like Sudan, Chad's oil fields are land-locked – far from ports and marine tankers. The oil fields are located in the southern corner of the country, in Doba. It is 1,070 kilometers from the fields to Kribi, the destination port, and the bulk of the pipeline corridor is located in Cameroon. The Doba oil fields are thought to contain one billion barrels of recoverable oil and production will peak at 225,000 barrels per day. In comparison to Sudan, Chad's oil fields are less prolific, but closer to marine

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[1] EssoChad, a subsidiary of ExxonMobil, is the lead company (40%) in a consortium, which includes Petronas (35%) and Chevron (25%). The World Bank participated by loaning Chad and Cameroon funds for equity participation in the pipeline (World Bank, 2003).

terminals. Pipeline development costs for the Chad-Cameroon pipeline are, however, two to three times the money spent in Sudan.

Planning for the Chad-Cameroon pipeline took seven years with extensive consultation among all of the parties impacted. According to the World Bank (2001, p. 4) there were over 900 public consultation meetings in the 300 villages along the pipeline route. In addition, there were 250 meetings with non-governmental organizations (NGOs). The consultative process resulted in rerouting the pipeline to avoid environmentally sensitive areas, the endowment of a fund to support two new national parks, and an increase in planned compensation for those suffering the impact. The consortium and the World Bank were especially sensitive to the project's impact on the environment. Despite the increase in cost, ExxonMobil agreed to bury the pipeline, minimizing the impact on crops and grazing, pay compensation, etc., and add safeguards to reduce the risk of oils spills. The new parks are specifically aimed at creating greater biodiversity. In addition, of course, the project created construction jobs as well as developing badly needed infrastructure – roads, buildings, etc.

The World Bank's consultative process does not end with planning. Throughout the construction phase the project will be monitored for "environmental, safety, health and socioeconomic standards and guidelines" (World Bank 2001, p. 8). In addition: "A unique revenue management law adopted by Chad requires that 90% of oil revenues be spent on education, health care, rural development, and infrastructure improvements." (World Bank 2003, p. 9)

The World Bank's approach to Chad-Cameroon pipeline has been praised and held out as a model for 21st Century development. Writing in *Fortune* magazine Jerry Useem (2002) commented that: "This was something new—a venture in which multinationals, governments, NGOs, and the World Bank all shared a stake. Some dare to herald it as a new and better model of globalization." Enthusiasm for this new model is somewhat muted, because as Useem points out, $4.5 million of a $25 million pre-payment made in late 2000 was spent on arms.

Picking through the hype, the consultative process concerning the environment and impact on indigenous peoples seems to be a success. Without question, it is a clear advance over past procedures (or Sudanese oil development), where costs thrust on others were simply ignored. Nonetheless, it raises some uncomfortable questions. The World Bank certainly had leverage on Chad and Cameroon in the planning stage, but that influence will dissipate rapidly once the oil and associated revenue begins to flow. Most importantly, most of the economic rent from this project is concentrated in the hands of Chad's political rulers whoever they might be. Continued reform and disbursement of the benefits of oil development to the general population depend on the good will and honorable intentions of the government. In this respect, the oil industry has a sorry record throughout Africa and the Middle East. As Terry Karl (1997) has ably documented, oil wealth in developing countries has brought far more misery than prosperity.

Indeed, the World Bank deal for Chad is already looking a bit shabby around the edges. Paul Brown (2002), writing for the *Guardian* claims that: "Embarrassed World Bank officials have already admitted that the notoriously corrupt Chad government has spent £10 million of grant money it received from the consortium on arms for its security forces rather than on the educational and development projects for which the money was intended." Precise spending records are unclear, because monies in government budgets are fungible. In any case, the CIA reports Chad's military spending in FY 2001 at $31 million. This is far less than Sudan's estimated $581 million, but oil has yet to flow. Brown also quotes Archbishop Desmond Tutu: "The Chad/Cameroon project is not the help we asked for or needed. In the absence of the rule of law and respect for human rights and the environment, financing of large-scale oil development is destroying the environment and us." The Archbishop's view mirrors that of most clergy active in the African continent; they have strong reservations about the benefits of oil and gas development.

"Top-Down" or "Bottom-Up" Development

Opinion seems curiously schizophrenic about the World Bank's Chad-Cameroon pipeline project. On the one hand, its complex process of planning and consultation satiates the NGO's compulsion for process – detailed planning, monitoring, review, reporting, auditing, oversight, etc. On the other hand, the imperfections are all too obvious. Dissatisfaction bubbles continuously from unexpected sources; anything from a disgruntled laborer to millions of dollars in misallocated funds may find its way into the public arena. The process itself is slow and costly. Such high transaction costs can be covered by the economic rent that large oil and gas development projects generate, but it is clearly not suited for day-to-day commerce and most development projects, which are not nearly as profitable. And, to the extent that the process is excessive and redundant, it is a misallocation of resources – a dead-weight loss that citizens of these countries will have to bear.

The results also stray from the World Bank's primary objective – economic development. Fundamentally, it is a "top-down" process of reform, led by an army of well-educated and well-meaning bureaucrats, but it is unlikely to foster fundamental reforms in commercial relationships that are so essential in nurturing genuine economic progress. The policy fails primarily because it concentrates vast resources and associated economic wealth in the hands of a few political leaders. Obviously, their primary motivation will be to reinforce control of the resource, rather than to cultivate economic progress. Is it any wonder that arms and munitions were the first items purchased from oil revenue in both Sudan and Chad? In this respect, the World Bank's laborious undertaking in Chad and Cameroon does not seem to matter. And, as petroleum revenue begins to build, the Bank, and the overseeing NGOs, will have less and less control.

Many of the world's oil-rich nations descend from nomadic cultures, where political organizations are built on family and tribal relations, rather than on ownership and control of specific parcels of land. This is, of course, quite different from the traditions of Europe's feudal society which was organized through land estates held "in fee" from the king (Davis 1989). In this regard it is instructive to review the text of the Magna Carta. When Bad King John agreed to its provisions, he conceded the principal that even the King was not above the law. Moreover, this document is thought to be the origin of British common law, which now, in one form or another, governs most of the world's commerce. The Magna Carta is especially relevant to oil-rich developing countries, because it deals with the rights of subjects with respect to their sovereign; an issue that has yet to be sorted out in much of the Middle East and Africa.

The original text of the 1215 AD Magna Carta had 65 clauses (Davis 1989). Of the sixty-five, 9 dealt with inheritance, 4 with debts, 6 with taxes, 5 with rights of the Crown vis-à-vis the owners of private property, 1 concerned the setting of standards and weights, 22 with procedures for settling disputes, and 18 were miscellaneous. Today's institutional economics would note that the Magna Carta focuses on two of the four elements of transaction costs, *enforcement* and *measurement*. The document did not directly address *information* and *bargaining* costs. Even a superficial reading of the Magna Carta makes it clear that it is all about "rights" and their enforcement – the crucial first steps in developing a workable system of exchange.

There is no specific provision in the Magna Carta that deals with the enforcement of contracts, just as there is no guarantee of freedom of speech and assembly. These modern concepts evolved over centuries. Nonetheless, it is illuminating to note that the Magna Carta deals mostly with the humdrum details of commercial life: the right to pass down property to heirs; the circumstances under which debts must be repaid; taxes; the establishment of institutions to settle disputes, etc. The "rule of law," to which Archbishop Tutu and others refer to, concerns human rights, and is largely omitted from the Magna Carta.

Two broad generalizations can be drawn from this brief sketch of the history of the rule of law. First, it has been evolutionary – a "bottom-up" approach. The Enlightenment, America's Bill of Rights, the Nuremberg trials, or the new International Criminal Court are all part of a step-by-step evolution that has taken nearly a millennium to unfold. Second, human rights are largely derived from the laws and institutions that govern commercial activity. As Friedrich von Hayek and Chicago-school economists have observed, human rights and property rights are inseparable. They are inseparable because property by itself has no rights; it is human beings that benefit from the right of owning and using property. In any case, the lawyers, judges, sheriffs, police, and courts that protect citizens from rape and murder also protect them from theft and burglary. When these institutions are central to the protection of economic relationships then society, as a whole, has a compelling incentive to get it right, to make things work.

Even the advanced societies of the Middle East suffer from the capricious behavior of political rulers. According to Robert Baer (2003) in Saudi Arabia, Saudi Princes "would pick out a valuable piece of property – maybe a particularly good location for a shopping mall or a new road – and then order a court to condemn it in the name of the state—and then order a court to clear the way for the king to award it to him." Obviously, in such a society private investment and economic initiative will be seriously curtailed. And this seems to be the case in Saudi Arabia, where the economy is sporadic and inefficient and probably would not exist at all if it were not for the oil and gas found there.

How to Achieve Meaningful Reform and Promote Economic Development

It is argued here that a "top-down" approach to political reform and economic development will not work. The mix of political and economic concentration is dangerous and harmful. How then, can nomadic and economically undeveloped countries with rich natural resources reform in a meaningful way? It should begin with the principals of diversified private property ownership and the separation of enforcement from ownership.

Professor Morris Adelman has suggested that the Iraq War creates an important opportunity for reform. Instead of organizing Iraq's oil industry in the traditional Middle East way, the resource should be subdivided into leased parcels and the parcels auctioned off to private companies. Either the proceeds of the sale (or ownership rights to the parcels) could be disbursed directly to the Iraqi people. There are precedents for something like this: Alaska has a "Permanent Fund" which conveys an annual cash payment to residents, with investment funds derived from royalties and taxes from the Prudhoe Bay oil field and other state-owned resources.

Alaska provides another interesting example of how to include indigenous peoples in the process. The creation of property rights creates value, and that is followed quickly by another creation: property taxes. North Slope oil development involves a lot of tangible investment – buildings, wells, pumps, pipelines, etc. Under Alaska law, the North Slope Bureau has a right to levy property taxes on this property. This has provided a flow of income to the community most affected by the development. Among other things, there is an interesting tension in the community. Higher tax rates on petroleum property generates more revenue but it also increase taxes on local homes, commercial properties, etc. There is nothing like a proposed tax increase to stir up concern and generate community involvement.

Disbursing tradable private property parcels of a rich natural resource to a developing country's citizens could have a distinct advantage in creating incentives for economic development. First, of course, it would spread the wealth to the poor that really need it, instead of concentrating it in Swiss bank accounts and arms purchases. Second, placing resource development in private hands is likely to improve economic efficiency and insure optimum investment. Third, tradable private property will create a powerful incentive to develop the legal institutions necessary to facilitate trade and commercial activity. If these institutions follow the historical paradigm, they will also lead to greater human rights. It is, of course, true that most recipients of such a windfall will spend it on chewing gum, tobacco, and alcohol, but not everyone will indulge; some will trade and accumulate. The economy that develops from this trade will be better suited to its environment than one designed in Washington D.C., London, or Paris.

Exchange is most efficient when the enforcement of contracts is separated from ownership rights. Developed economies achieve this by having police and judiciary that are indifferent to the outcome of commercial disputes. If enforcement mechanisms have vested interests in the property rights of goods and services exchanged, the outcome is likely to be highly inefficient. In most oil-exporting countries where political leaders control the oil wealth, the separation of ownership rights and enforcement is muddled, but it does not have to be.

Conclusion

That the Sudan and Chad-Cameroon projects – developed under vastly different circumstances and goals – might end up with equally dismal results is much more than ironic; it is a sad comment on the state of our knowledge and expertise in fostering economic growth through large infrastructure projects. It will take several years for the World Bank's experiment in Chad and Cameroon to run full course and it is too early to make a final judgment. Nonetheless, it will be difficult for this development to achieve its goals; public sector stewardship of natural resources has an absolutely dismal record and it is not clear that the new process will correct the fundamentals.

In Chad and Cameroon, the World Bank is seeking to create a middle class standard of living, without creating a middle class. At best, this is a dubious undertaking. Concentrating the benefits of oil development in the hands of those that control the government creates a demand for arms. Alternatively, diversifying natural resource property rights creates a demand for exchange and trade. Which structure is better suited for economic progress?

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