8

Conclusion

Rent Seeking and Rent Seizing

This book began with three puzzles: Why did the governments of the Philippines, Malaysia, and Indonesia squander their forests? Why do most governments in the developing world squander commercially valuable forests? And why do developing states generally mishandle resource windfalls? The book's research design – which emphasizes validity over generality – gives me a good deal of leverage over the first question, but less over the second and third questions. Here I summarize the book's findings, and discuss the implications for both policy analysts and social scientists.

POLICY FAILURES IN THE PHILIPPINES, SABAH, SARAWAK, AND INDONESIA

All four states in this study had exceptionally valuable forests. Three of them (the Philippines, Sabah, and Sarawak) initially had relatively strong forestry institutions, and nominal policies of sustained-yield harvesting. Yet all four governments wound up squandering their forests, by authorizing logging at unsustainable rates, by keeping royalties and taxes low, and by failing to enforce logging regulations.

There were undoubtedly many reasons for these policy failures. This book focuses on a single cause: the rents created by high timber prices. When timber prices rose high enough to generate rents, governments in three of the four states (the Philippines, Sabah, and Sarawak) stripped their forestry departments of much of their authority over the timber sector, and abandoned their policies of restricting logging to sustained-yield levels. In the fourth case (Indonesia), the government's forestry institutions were weak to begin with; still, the jump in timber prices after 1969 had a harmful effect on nonstate institutions that protected the forests, the institutions of customary law, or *adat*.

Why would timber booms have such a damaging effect on forest institutions and policies? Chapter 3 noted that observers offer two types of explanations for the policy failures caused by natural resource booms: cognitive explanations, which suggest that resource windfalls cause myopic disorders among policymakers; and societal explanations, which suggest that windfalls encourage nonstate actors – such as interest groups, political clients, and rent seekers – to demand a share of the windfall from the government.

The case studies suggest that neither irrational sloth nor irrational exuberance can explain why government policies so quickly deteriorated. Contemporaneous reports from both the government's own foresters, and from intergovernmental advisory bodies, show that policymakers in the Philippines, Sabah, and Sarawak were repeatedly warned that they were authorizing logging at unsustainable levels – in violation of their own nominal policies – and that doing so would have harmful economic, social, and environmental consequences. Of course, it is impossible to know how well informed individual policymakers were. Yet longitudinal comparisons within the Philippine, Sabah, and Sarawak cases suggest that limited information cannot explain their postboom policy failures, since their information was equally (or more) limited before their countries' timber boom, when policies were more prudent and sustainable. There is little evidence that policy failures were caused by cognitive shortcomings.

There is a great deal of evidence, however, the policy failures were partly caused by rent-seeking pressures from private actors. In all four cases, logging permits were distributed to major campaign donors, influential constituents, and the friends, relatives, and cronies of top politicians. When timber exports boomed in Sabah in the early 1960s, Chief Minister Donald Stephens found that the great majority of his visitors came to request timber licenses; his counterparts in the Philippines, Sarawak, and Indonesia no doubt felt similar pressures.

Chapter 3 suggests an additional reason why resource booms commonly lead to policy failures: rent seizing. It defines rent seizing as "efforts by state actors to gain the right to allocate economic rents"; it also specifies four hypotheses. The first is that when a state receives an economic windfall, public officials will attempt to gain the right to allocate it, in the form of economic rents, to others.

Do the case studies support this hypothesis? The answer is a qualified "yes."

In three of the four cases, there is a rough correlation between the time that rents arose in the timber sector, and the time that politicians sought the right to allocate timber concessions. In the Philippines, rents became available in the early-to-mid 1950s, and by 1956 President Magsaysay and members of congress were battling over allocation rights. The cases of Sabah and Sarawak are more complex, since in both states rents first became available under the British colonial government, which left local political leaders with no viable rent-seizing avenues. After the two states gained their own governments under the Malaysian flag in 1963, the struggle within the new cabinets over the allocation of forest concessions took center stage. Only in the Indonesian case is there no apparent causal link between the timber windfall and allocation rights, since President Suharto gained allocation rights in early 1967, before the timber boom occurred. By the time that timber concessions rose in value, they were already controlled by Suharto's close ally, Director General Sudjarwo.[1]

The second hypothesis is that politicians will try to maximize the value of their allocation rights, by making them more direct, exclusive, and discretionary. Although their ability to do so varied, politicians made these efforts in all four states. During his two elected terms as president, Marcos used a range of bureaucratic strategies to erode the forestry bureau's independence, and to gain more direct authority over license allocation; he also fought to exclude members of congress and members of his own cabinet from holding allocation rights. After declaring martial law in 1972, he took each of these measures further, and devised a clever system of export licenses that made his influence highly discretionary. Sabah's Tun Mustapha and Sarawak's Rahman Ya'akub took parallel measures to strengthen their allocation rights: both served as their own ministers of forestry; both transferred their forestry departments' powers to more secretive and flexible organizations (the Sabah Foundation, the Sarawak Foundation, and STIDC); and both amended the forestry laws to give themselves heightened discretion over the assignment and withdrawal of timber concessions. In Indonesia, when timber prices rose, President Suharto usurped the allocation powers of provincial governors and district heads. Although he delegated formal control over the

1 Note that the Indonesian case does not contradict the first hypothesis, since there may be other factors that cause politicians to seek allocation rights.

forestry sector to Director General Sudjarwo, Suharto's close personal ties with Sudjarwo, and Suharto's authoritarian powers, gave him relatively direct and discretionary control of the timber industry.

The third hypothesis is that these rent-seizing efforts lead to the weakening or dismantling of institutions that restrict resource exploitation. The governments of the Philippines, Sabah, and Sarawak were endowed with relatively strong forestry institutions prior to their timber booms: All had forestry departments that held a large measure of autonomy within the government, and that had historically sought to limit logging to sustained-yield levels. The rent-seizing campaigns of political actors dismantled these institutions or rendered them ineffectual. In both Indonesia and Sabah, the forests were protect by laws that recognized the customary land rights of forest dwellers. In both states, these laws were nullified in the wake of a timber boom.

The incentives for rent seizing and institutional dismantling are illustrated by Figure 8.1, which is a modified version of Figure 3.1. Supply

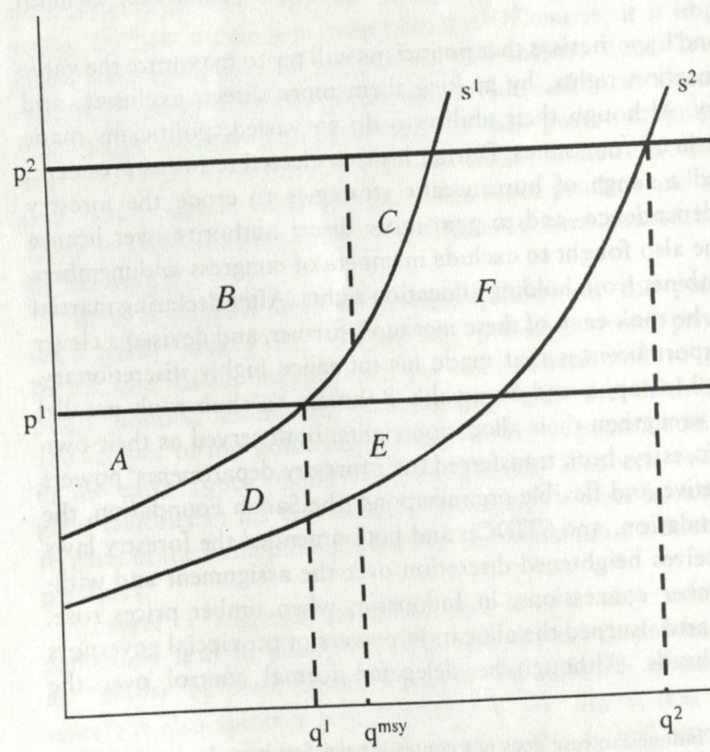

Figure 8.1. The Incentive for Unsustainable Logging.

curve S^1 represents the preferences of timber firms under "normal" conditions, when government institutions are properly regulating the industry. If prices are at the normal level P^1, firms will cut a quantity of timber q^1; in this illustration, this quantity is just below the maximum sustainable yield q^{MSY}. This approximates the situation in the Philippines before 1955, in Sabah before 1965, and in Sarawak before 1978. In each case, the price of timber then rose from P^1 to P^2, creating a new pool of rents B that acted as an incentive for rent-seizing behavior. In these three cases, politicians dismantled the forestry institutions that restricted their ability to allocate these rents.

Politicians also recognized that by enforcing regulations on sustained-yield harvesting, they were forgoing a further quantity of rents, represented by area C. By allowing firms to harvest above the maximum sustainable yield, they gained access to these rents as well.

Moreover, once they had stripped their forest departments of their political autonomy, state actors were able to reduce the logging costs of license holders by allowing them to ignore silvicultural and environmental regulations and by eviscerating the rights of forest dwellers. This enabled loggers to shift their supply curve from S^1 to S^2. As a result, firms could profitably log quantity q^2, creating a further cache of allocable rents – or "ransack rents" – represented by areas D, E, and F.

The fourth hypothesis concerns the rate at which politicians allocated the rents represented by areas A through F. It states that the rate at which a politician will allocate rents – approximated by the harvesting rate – will be influenced by the exclusivity of their allocation rights, and their security in office. This final hypothesis is difficult to illustrate (much less test), because the harvesting rate is influenced by many other factors, ranging from changes in technology to fluctuations in overseas timber markets. Still, there is evidence both within and across the cases to support this hypothesis. In the Philippines, Marcos took important measures to slow the harvesting rate after he declared martial law in 1972 and gained both more exclusive control over timber rents and greater security in office. Indonesia's Suharto held exclusive allocation rights and was an exceptionally secure autocrat through the mid-1990s. He also kept logging to the lowest rate of the four cases: In the 1970s and the first half of the 1980s, it was below what foresters believed was the sustained-yield rate, while in the 1990s it rose to between 1.5 and 2 times this rate.

The cases of Sabah and Sarawak are broadly consistent with hypothesis four, once we control for the creation of ransack rents. Both

Sabah's Tun Mustapha (between 1967 and 1970) and Sarawak's Rahman Ya'akub (between 1970 and 1979) dismantled restrictions on logging activity after taking office, shifting out the timber industry's supply curve and creating ransack rents; as a result, they also increased their states' harvesting rates. Once this process was complete, we can see the influence of exclusivity and political security on harvesting rates. Sabah's chief ministers have consistently held exclusive allocation rights; but since they have been perpetually insecure – and repeatedly defeated in elections – their allocation rates have been high, rising to ten times the sustainable level in the early 1990s. Sarawak's chief ministers have also held exclusive allocation rights, except between 1981 and 1985, when Taib was forced to share these rights with former Chief Minister Rahman Ya'akub. During the first year of this shared arrangement, harvesting rose 27 percent, from 8.8 million to 11.2 million cubic meters a year; over the next four years it leveled off. But between 1986 and 1991, Taib's security in office dropped sharply, as he faced two highly contested elections. During this spell the harvesting rate rose more than 70 percent, from 11.4 to 19.4 million cubic meters – between four and five times the sustainable level. Twelve months after the 1991 election, which Taib won decisively, the forest department ordered license holders to reduce their output.

While the data on timber rents, rent seeking, and institutional change are incomplete, the four case studies are broadly consistent with the hypotheses laid out in Chapter 3. Collectively, they illustrate how commodity booms can harm state institutions and policies, and lead to the overrapid dissipation of a windfall. They also show how rent seeking and rent seizing go hand-in-hand: When private actors have incentives to seek rents, public officials gain incentives to supply them – a process that may have disastrous consequences for the governance of natural resources.

WHY DO DEVELOPING STATES SQUANDER THEIR FORESTS?

The case studies suggest that rent seizing was an important source of policy failure in the Philippines, Malaysia, and Indonesia. Can this finding be applied to other developing states? It is impossible to know without examining other cases in detail. Still, three observations can move us closer to an answer.

First, the domain of relevant cases – that is, the states that are vulnerable to rent seizing in their forest sectors – consists of all developing states whose natural forests have enough commercial value to generate rents. In the late 1990s, developing states had an estimated 15.275 million square kilometers of forest; according to one study, rents were available in about 27 percent of these forests (Bryant, Nielsen, and Tangley 1997). These rent-generating forests were governed by at least a dozen states, including Brazil, Burma, Cambodia, Cameroon, Côte D'Ivoire, Congo-Brazzaville, Congo-Kinshasa, Equatorial Guinea, Gabon, Ghana, Laos, Papua New Guinea, and the Solomon Islands.

Second, the presence of forest rents – and, hence, the danger of rent seizing – in any given state depends in part on market conditions. The international demand for hardwood timber remained strong through the late 1990s, and was expected to remain strong well into the twenty-first century. At the same time, the major suppliers of the 1990s, Malaysia and Indonesia, were quickly depleting their forests. This suggests that international timber prices will continue to rise, and create rents in these and eventually other forested states.

Finally, there are indications that rent seizing has already been a problem in several states, notably Cambodia and Papua New Guinea. In Papua New Guinea the government established a new forest authority in the early 1990s to govern the fast-growing timber industry. The authority was designed to keep logging to sustainable levels and free from political interference; it was strongly backed by reformist bureaucrats, local nongovernmental organizations (NGOs), and the World Bank. Yet the authority was forced to battle both members of parliament and the prime minister, who repeatedly tried to strip away its autonomy and gain control of the licensing process.

Without examining a broader sample of cases, we cannot know if the poor forest policies of other states have been caused, in part, by rent seizing. But if rent seizing does affect other countries, twelve heavily forested states in Latin America, Africa, and the Southeast Asia-Pacific region appear to be most vulnerable in the coming years.

WHY DO STATES SQUANDER THEIR WINDFALLS?

According to classic models of economic development, commodity booms should boost economic growth in newly industrializing states. Yet Chapter 2 notes that developing states often grow more slowly after commodity booms. Their governments also tend to mismanage their windfalls. In some cases, policymakers may not know the correct policy response to a positive trade shock; in other cases, they may know the correct response but lack the administrative capacity to implement it. Chapter 2 notes, however, that often policymakers have both the requisite knowledge and administrative capacity, yet still handle their windfalls poorly. It is this last set of policy failures that present a major puzzle.

Because I only examine cases of timber-exporting states in Chapters 4 through 7, I cannot make strong inferences about states that export other types of natural resources. Let me instead offer three conjectures about the policy failures of commodity exporters.

First, commodity windfalls do not make public officials unduly short-sighted. Of course, policymakers are often myopic, and they often lack the information they need to respond properly to positive trade shocks. As Deaton (1999: 35) notes, commodity booms "provide serious challenges for the best-informed and most adept of social planners." My conjecture is simply that windfalls do not make state actors more short-sighted than they were before. This claim may seem obvious, yet a great many studies imply that windfalls cause myopic behavior.

Second, rent-seeking pressures from powerful individuals, classes, or interest groups create serious problems for policymakers. States with different regime types may distribute their windfalls to different constituencies; still, when states undergo resource booms distributive pressures are ubiquitous, and make the prudent use of windfalls difficult even for skillful political leaders.

Finally, windfalls may also cause rent seizing, which are efforts by state actors to capture the right to allocate rents to others. Rent seizing accompanies rent seeking: When private actors seek rents, public officials have an incentive to supply them. Rent seizing can be more pernicious and harder to mitigate than rent seeking, since state actors have rule-making and rule-enforcing powers, and hence the ability to dismantle institutions that would otherwise restrain them. Institutions can become endogenous to rent-seeking struggles, and collapse.

How well does the book's model of rent seizing fit the larger set of cases? There is no easy answer to this question, but other scholars have observed processes that look much like rent seizing in other settings. Bates (1981: 14) found that when agricultural marketing boards in Africa accumulated surpluses, the central governments "sought, and won, control over the revenues." Davis's (1983) study of ten African and Latin American coffee, cocoa, and tea exporters during the 1975–8 boom notes that governments repeatedly appropriated the surpluses held by stabilization funds. According to a World Bank study of eighteen agricultural exporters, stabilization funds were used by governments to facilitate "enormous transfers" of wealth from the rural sector to urban consumers, industry, and the state itself (Schiff and Valdes 1992). Similarly, studies by Auty (1990), Karl (1997), and Collier and Gunning (1999) have shown that oil and mineral-exporting states frequently have difficulty protecting their windfalls from political interference, and from appropriation for patronage, corruption, and pork barrel projects.

HOW CAN TROPICAL FORESTS BE BETTER PROTECTED?

The cases of the Philippines, Malaysia, and Indonesia hold both good news and bad news for those who wish to better protect the world's tropical forests from unsustainable logging. The good news is that poor information has *not* been an obstacle to improved rainforest management. Since at least the 1950s, foresters and public officials in Southeast Asia have understood the virtues of sustainable forest management; when allowed to do so, foresters have been able to implement at least rudimentary forms of sustained-yield management. Better information about forest ecology may improve public policies. But the disastrous forest policies of the states in this study were caused by political forces, not by a lack of information.

The bad news is that the international trade in tropical timber poses a serious threat to many of the remaining forests – a threat that has been poorly understood and may be difficult to mitigate. Some scholars have argued that the international timber trade may help protect tropical forests, by making it profitable for actors in developing states to sustainably manage their forests, instead of converting the land to nonforest uses. Others argue that the impact of the timber trade on tropical deforestation is small or negligible. A 1993 report prepared by the London Environmental Economics Centre, on behalf of the ITTO, concludes that

> the international tropical timber trade is not a major source of tropical deforestation. Not only is the conversion of forests to other uses such as agriculture a more significant factor, but an increasing proportion of tropical timber harvested in producer countries is for domestic consumption . . . only 6 percent of total tropical non-coniferous roundwood production enters the international trade. (London Environmental Economics Centre 1993: iii)

The ITTO study and others like it tend to underestimate the damage done by the timber trade. They correctly note that when developing states properly manage their forests, the international timber trade should do them no harm. But the international timber trade itself may damage the ability of states to manage their forests sustainably, by creating much larger rents than the domestic timber trade; these rents can set off both rent seeking and rent seizing. Timber exports can indirectly weaken forestry institutions and damage sustained-yield policies.

To better protect the forests, advocates should worry less about the ignorance of policymakers and more about the effects of international markets. The policy options are much the same for the forest sector as they are for other natural resource sectors.

WHAT SHOULD BE DONE?

There are at least four possible ways to mitigate the problem of rent seizing.

The most comprehensive approach would be to reduce the incidence of windfalls by stabilizing international commodity markets. Over the last several decades, international markets for natural resources have grown increasingly volatile (Reinhart and Wickham 1994). Yet for better or worse, international market stabilization has already been tried, and failed utterly. From the 1960s to the mid-1990s, international commodity agreements were forged to support the prices of sugar, cocoa, coffee, rubber, and tin; each of these agreements fell apart (Gilbert 1996). Negotiations to stabilize markets for some two dozen other commodities either produced no results, or ineffectual agreements. A study by Cashin, Liang, and McDermott (1999) suggests that the duration of price fluctuations in international commodity markets may make international stabilization funds impractical.

A second approach would encourage governments to better protect their windfalls by shrouding them in secrecy. Several states have already tried this. In the 1970s, the Indonesian government hid some of its oil revenues in clandestine accounts. The government of Cameroon placed its oil windfall in secret offshore funds that were controlled by the president's office. The Botswanan government listed its revenues from booming diamond exports in obscure items at the bottom of the state budget, to conceal their magnitude (Bevan, Collier, and Gunning 1993). The drawbacks of this approach are self-evident: While the opportunities for corruption are restricted to a smaller set of state actors, these actors will find corruption even easier than normal. Moreover, a strategy of secrecy can only be sustained as long as the incumbent government remains in office.

A third and more plausible option would be to keep the windfall out of the hands of the state. As Collier and Gunning (1999) suggest, private agents tend to manage windfalls better than their governments, provided they have uncontaminated information about the windfall's source and duration. States can transfer the job of capturing windfalls to the private sector by privatizing state-owned resource enterprises, and encouraging private trade groups to organize their own stabilization funds. There are two important constraints on this approach. First, even when a windfall goes directly to the private sector, a portion may still accrue to the state, since commodity booms tend to boost tax revenues. Second, privatization is likely to be a poor option when it comes to old-growth forests, particularly tropical forests where people live, farm, and hunt. Logging in the natural forests of the moist tropics creates numerous social and environmental externalities. Private actors have little incentive to internalize these costs, and in the absence of strong government regulation, can permanently damage the forests and the human communities that live in them. Still, for other natural resources, privatization may help forestall the problem of rent seizing.

The fourth approach would be to use third-party enforcement to help curtail rent seizing. When the state's normal enforcement mechanisms become endogenous to the rent-seeking process, third parties can help force the government to use its windfalls prudently. In the 1980s and 1990s, some international funders – including the World Bank, the IMF, and the Asian Development Bank – began to take on this role. After Marcos fell from power in the Philippines, members of the Aquino government covertly invited the World Bank and other donors to "impose" conditions on their loans to the government, to help bind the government to a plan of forestry reform (Ross 1996). In Papua New Guinea, the World Bank protected the government's forest authority from political interference by repeatedly threatening to withhold funds. During the 1997–8 Asian financial crisis, the bank forced the Indonesian government to reform its forestry practices. In Cambodia, the IMF has pressured the government to halt excessive logging and collect revenues from the timber industry.

This approach, too, has limitations. In general, attempts by international funders to impose policy conditions on reluctant governments have worked poorly (Mosley, Harrigan, and Toye 1991; Ross 1996).

Conditionality works best when the recipient state is small, and its government relies heavily on international donors; or when a larger government is in crisis and has little choice but to accept the donor's demands. In most other cases, governments find ways to evade or counteract the conditions they dislike.

NGOs also can act as third-party enforcers; in states that are larger and more democratic, they may be more effective than international donors. In the Philippines, a vibrant NGO movement has helped put far-reaching forestry reforms in place. To be effective, NGOs must find ways to offset the powerful incentives created by rents. One reason Philippine NGOs were effective was that by the late 1980s the remaining forest rents were small (Ross 1996). But when the rents are large – such as in Venezuela during the oil booms of the 1970s, or Sarawak during the timber booms of the 1980s and 1990s – NGOs can be overwhelmed.

IMPLICATIONS FOR THE STUDY OF POLITICAL ECONOMY, INSTITUTIONS, AND RENT SEEKING

This study has implications for two debates in the social sciences: one about international political economy, the second about institutions and rent seeking.

Scholars of international political economy have long studied the influence of international markets on developing states. From the early 1950s to the late 1970s, many argued that the international economic system placed developing states at a disadvantage. Third World states – particularly those that exported primary commodities – were said to be locked in a permanent state of underdevelopment, due to the declining terms of trade for primary commodities, the instability of international commodity markets, the influence of First World corporations and governments, and class alliances between First World and Third World elites.[2] These criticisms culminated in the 1970s in the push for a "New International Economic Order" that would overturn the international division of labor, and remove what were viewed as systematic biases against Third World development.

Since the early 1980s, these critiques have largely faded. Many economists and political scientists now suggest that international

2 See, for example, Singer (1950); Baran (1952); Gunder Frank (1966); Wallerstein (1974); Evans (1979); Cardoso and Faletto (1979).

markets have a beneficial effect on developing states, by encouraging them to adopt more prudent fiscal and monetary policies. Governments that maintain fiscal and monetary discipline and minimize corruption will be rewarded by foreign investors; those that do not will be penalized.

This study seeks to modify the conventional wisdom by pointing out one way that international markets can have a harmful effect on states, at least in natural resource sectors. In manufacturing sectors the standard logic may hold: governments are more likely to attract foreign investment when they maintain sound economic policies. But in resource sectors – particularly minerals, oil, and timber sectors – this incentive is much weaker, since rents will attract investors even when economic policies are poor and corruption is high. Investors in manufacturing sectors can, in the long run, earn only "normal" profits; they must hence pay close attention to the state's ability to maintain a stable economic environment, since instability and poor governance can erode their slim profit margins. But exhaustible natural resources create rents, allowing foreign investors to profit even when economic conditions are poor. Natural resources are also geographically specific: extractive firms must go where the resources are. In states that are politically and economically unstable, manufacturers will flee, but resource firms are more likely to stay – for example, in Angola, Burma, Congo-Kinshasa, Indonesia, Kazakhstan, Liberia, Nigeria, and Sierra Leone. International markets are less likely to reward the good institutions and policies, or penalize the bad institutions and policies, of states that export minerals, oil, and timber.

Moreover, international commodity markets can damage the institutions and policies of developing states, by creating incentives for both rent seeking and rent seizing. Rent seizing is exceptionally hard to remedy, because it harms the very institutions that states rely on to foil corruption. States with strong resource institutions, like the Philippines and Malaysia before their timber booms, may see these institutions dismantled. States without strong institutions, like Indonesia in the 1960s, may find it harder to build them. International markets may have a beneficent effect on states' manufacturing sectors, but they can have perverse effects on their resource sectors.

This book also has implications for the study of institutions and rent seeking. It describes a type of rent seeking that has been overlooked, and can lead to the deterioration of state institutions. It also shows how state institutions can become endogenous to the pursuit of rents. This may complicate the analysis of rent seeking in important ways. Most formal studies of rent seeking treat both institutions and rents as exogenous, and focus on the economic consequences of rent-seeking behavior in carefully specified settings. A handful of studies treat institutions as exogenous but rents as endogenous, noting that when state institutions are "weak," state actors may create rents that can be allocated to private actors (Appelbaum and Katz 1987; McChesney 1987).

This study shows one way that institutions can be treated as endogenous to the struggle over rents. It suggests that while weak state institutions may allow rent seeking, rent seeking can weaken state institutions – producing a downward spiral of eroding legal, administrative, and political restraints.

Treating state institutions as endogenous may make the analysis of rent seeking less tractable; but scholars should not grow entranced with their heuristic assumptions. Policy analysts routinely urge governments to strengthen their institutions to reduce rent seeking, corruption, and other ailments. Yet state institutions are sometimes harmed by the problems they are supposed to solve; they become endogenous to the conundrums of development.

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