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Curse or Cure - China, Africa, and the Effects of Unconditional Wealth

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Curse or Cure? China, Africa, and The Effects of Unconditioned Wealth

Patrick J. Keenan*

I.
INTRODUCTION

How are the human rights practices of governments affected by their wealth or poverty? Much of the answer to that question has to do with how governments obtain that wealth. In the past five years, there has been a surge of interest in the plight of poor countries. From *Vanity Fair* magazine’s special issue on Africa, to the Live 8 concerts designed to pressure rich countries to increase aid flows to poor countries, Western consumers of popular culture have had no shortage of opportunities to offer their assistance to those living in poverty in other countries. Policymakers have offered a laundry list of remedies, all based on a common premise—that the economies of many poor countries, particularly those in Africa, have stagnated while those in other parts of the world have enjoyed impressive growth.1 In the debate about how best to

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1. For example, in 1981, 42% of people living in sub-Saharan African existed on less than $1 per day. A dozen years later in 1993, the figure was 45%, and by 2004, the figure was 41%. *WORLD BANK, WORLD DEVELOPMENT INDICATORS* 3 (2004). By way of comparison, consider the percentages of people living on less than $1 per day in other regions:

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help poor countries, one side argues that the most effective way is for wealthier states to provide more and more foreign aid. On the other side are those who maintain that foreign aid is the problem, not the solution, and argue that market forces are the most likely engine of development and improvements for the human condition.

Both sides of this debate share the assumption that infusions of wealth from the outside in one form or another will improve the lives of people in poor countries. But is this true? Economists have long noted an association between economies dominated by sales of natural resources, such as oil or diamonds, and a range of ills, including weak economic development, corruption, and violations of human rights. Similarly, most infusions of foreign aid have had little positive effect on recipient states. Missing from most policy debates about the optimal ways for wealthy countries to assist poor countries is a coherent theory of conditions on investment and aid. How is the behavior of states affected by the manner in which they receive financial support?

China’s recent interest in Africa provides a sort of natural experiment in which to consider the relationship between wealth, the conditions associated with wealth, and state behavior. The unparalleled pace of China’s growth and its changing role on the global stage has had tremendous consequences in almost all areas of life around the world. In just the past five years, China has increased its activities in Africa at a staggering rate. In the first three quarters of 2007 alone, trade between China and Africa was just over $50 billion, a 42% increase in just one year. Upwards of 750,000 Chinese people have recently lived or worked in Africa. Chinese companies have reportedly received half of the new public works contracts in Africa in recent years. The economic and strategic


4. See discussion infra Parts III.B & IV.

5. See discussion infra Part III.C.

6. William Wallis, Drawing Contours of a New World Order, FIN. TIMES SPECIAL REPORT, Jan. 24, 2008, at 1 (reporting that trade between China and Africa was $50.6 billion for the first nine months of 2007).

7. Africa-China: Influx of Workers, 44 AFR. RES. BULL. 17510 (2007) (reporting that the official news media in China reports that “there were at least 750,000 Chinese working or living for extended periods” in Africa).

8. Wallis, supra note 6, (reporting that, “[b]y some estimates, Chinese contractors are winning 50 percent of all new public works projects in Africa, edging out competitors with higher overheads”).
consequences of China’s increased focus on Africa have been the subject of much debate in the U.S. and around the world,9 but much less attention has been paid to the likely social consequences of China’s increased interest in Africa.

Nevertheless, the rise of China has brought some attention to the social consequences of unconditioned wealth. With its willingness to spend foreign currency reserves in ways often spurned by the West—such as buying oil from the pariah regime in Sudan, supporting Robert Mugabe in Zimbabwe, building roads in Gabon, or developing mines in Zambia—China’s activities raise serious questions about how human rights will be enforced in an era when states can obtain what they need—financing, arms, markets for their goods—without subjecting themselves to the conditions that Western governments attach to engagement and aid. In contrast to most Western governments and investors, China explicitly disclaims any desire to change the internal policies or practices of its trading partners and the recipients of its aid or investments.10 Its investments amount to what I will call unconditioned wealth, which creates the risk that the investments will cause harm rather than improve the lives of people living in Africa. This may, at first blush, seem obvious or tautological: wealth without conditions related to human rights will lead to human rights abuses. Conversely, it might seem offensive: why should we assume that governments that receive an infusion of wealth would abuse their citizens? But the reality is not so simple. Many argue that tremendous infusions of wealth—any type of wealth—will inevitably trickle down to the very poor and make their lives better. Using China’s recent investments in Africa, a helpful context in which to reconsider theories relating to wealth and conditions, I show why this is not true. Wealth does not inevitably lead to improvements in social welfare, and it does not inevitably cause governments to abuse citizens.

The focus of my inquiry is the relationship between the ways that poor countries acquire wealth and the human rights effects of that wealth. For my purposes, the relevant effects are the government practices and social conditions that have the most impact on the lives of local people in developing countries. Two of these effects merit special mention: poverty and oppression. For most poor people, their primary goal is to stop being poor. No responsible definition of human rights should ignore this reality. Poverty affects almost every aspect of the lives of poor people. Relative to their wealthier peers, poor people are


more likely to become ill and more likely to suffer because of their illnesses.\textsuperscript{11} Furthermore, poverty, when mediated by cultural norms and practices, can render women in particular vulnerable to a host of threats.\textsuperscript{12} For these reasons, when I examine the effects of wealth, one important consideration is whether that wealth is likely to alleviate poverty, particularly for the poorest people in the recipient country. But the alleviation of poverty is not the only effect that merits consideration. Another important factor is whether oppression is reduced: can wealth improve the ability of people to control their own lives? What this means depends greatly on the situation on the ground in each state, but there are some conditions that are likely important in almost every state. For example, freedom from governmental abuse is vital to the ability of most people to realize their goals.\textsuperscript{13}

My focus on the relationship between the sources of a state's wealth and the economic and social prospects of local people is particularly plausible given the justifications advanced on all sides of the development debates. Proponents of freer trade and market-based approaches to development justify their approaches in part by arguing that they will enhance social welfare, improve living conditions of poor people, and otherwise allow poor people to live freer, more secure lives.\textsuperscript{14} Yet, those who advocate increases in foreign aid make the same claims: more aid will lead to less poverty and more opportunities for poor people.\textsuperscript{15} China, in its Africa policy, touts the potential for its investments to reduce poverty as one of its goals.\textsuperscript{16} Increasingly, even corporations justify their activities in poor countries by highlighting their positive social impact.\textsuperscript{17} There

\begin{itemize}
  \item \textsuperscript{11} World Bank, Human Development Sector, Africa Region, \textit{Improving Health Outcomes for the Poor in Uganda} 4 (Africa Region Human Development Working Paper Series, 2005) (summarizing public health data and concluding that the "poor and vulnerable groups bear a disproportionately heavy burden of disease").
  \item \textsuperscript{12} See Julia C. Kim & Charlotte H. Watts, \textit{Gaining a Foothold: Tackling Poverty, Gender Inequality, and HIV in Africa}, 331 BRIT. MED. J. 769, 770-71 (2005) (describing the connections between poverty, the low social power of women under traditional norms, and their vulnerability to HIV and AIDS).
  \item \textsuperscript{13} See generally AMARTYA SEN, \textit{DEVELOPMENT AS FREEDOM} (1999).
  \item \textsuperscript{14} See, e.g., Stanley Fischer, \textit{Globalization and its Challenges}, 93 AM. ECON. REV. 1, 2 (2003) (arguing that "the surest route to poverty reduction is economic growth," and that "evidence strongly supports the conclusion that growth requires a policy framework that prominently includes an orientation toward integration into the global economy").
  \item \textsuperscript{15} See, e.g., SACHS, \textit{supra} note 2, at 266-87 (advocating increases in foreign assistance as a way to end poverty in poor countries).
  \item \textsuperscript{16} See \textit{China's Africa Policy, supra} note 10.
  \item \textsuperscript{17} A good example of this approach comes from the Corporate Council for Africa's mission statement. The CCA, which helps U.S. firms develop business in Africa, argues that: CCA members believe that Africa's future success depends upon the ability of its entrepreneurs and business people to create and retain wealth through private enterprise. American corporations and private individuals can contribute most effectively by building partnership and reaching out to the African private sector in the areas that America knows best: private enterprise, investment capital, technology transfer and management.
\end{itemize}
is, of course, reason to be skeptical of these justifications, and I do not argue that social considerations are the sole or even the primary motivation for corporate activity, foreign aid, or Chinese investment. Instead, I make the more limited claim that it is perfectly plausible to consider human rights impacts when assessing the effect of wealth on recipient states and their people.

In this Article, I make two principal claims: first, that the vast majority of wealth comes with conditions, and those conditions determine whether it improves social welfare; and, second, that China's recent investments in Africa are unconditioned wealth and are likely to decrease social welfare.

With regard to my first claim, I argue that the conditions associated with wealth determine whether wealth has a positive or negative effect on the recipient. Some conditions are explicit and aimed at ensuring that the recipient's behavior is (or becomes) consistent with the donor's strategic interests, but these conditions may have little to do with human rights. Much of the aid that flowed from the U.S. during the Cold War was of this type. When the U.S. provided support to Mobutu Sese Seko in the former Zaire, the principal objective of the U.S. was to ensure that Zaire—with its vast, if undeveloped, supplies of strategically-important minerals and uranium—did not shift its allegiances to the Soviet Union. During the Cold War, the U.S. and the Soviet Union used aid—humanitarian and military—to compete for the resources and loyalty of African states. With the collapse of the Soviet Union, the money dried up. No longer did the U.S. need to use foreign aid and investment to reward strategic allies. Instead, aid from the U.S. and from Western institutions such as the International Monetary Fund and the World Bank came with conditions attached, many of which sharply reduced social services and thereby weakened leaders in developing countries who used state handouts to ensure their political careers.


18. See, e.g., James Mecnik, et al., Testing Models of U.S. Foreign Policy: Foreign Aid During and After the Cold War, 60 J. POL. 63, 64 (1998) (concluding, based on empirical analysis of U.S. foreign aid allocations, that "security-driven goals have become less critical and ideological goals more important with the passing of the Cold War. ... [T]he United States is increasingly rewarding democratic states with foreign aid while reducing assistance to strategically important nations").

19. The reasons for this shift are complex, but two appear to be particularly important. First, ensuring that a state remains an ally of the U.S. became relatively less important after the Soviet Union collapsed. See id. at 64. Second, non-governmental organizations and other interest groups became more powerful and organized, and these organizations began to exert greater influence over foreign aid allocations and other foreign policy decisions. See, e.g., Kimberly Ann Elliott & Gary Clyde Hufbauer, Same Song, Same Refrain? Economic Sanctions in the 1990s, 89 AM. ECON. ASS'N PAPERS AND PROCEEDINGS 403, 405 (1999) (arguing that without "the constraints of the Cold War, the United Nations has been energized to respond to a variety of perceived threats to international peace and security. Narrow constituency groups also find that they have relatively greater influence in the absence of a clear consensus on what constitutes the national interest").
Other conditions on wealth are what I call market conditions, and in this category I include the kind of business climate a government fosters and the kind of social and human rights environment a government enforces. For example, when the largest bank in the world recently invested $2.4 billion in South Africa's leading bank, the investment created a powerful set of conditions for the recipient bank, and the host country, to safeguard the investment by refraining from behavior that would undermine its value. Added to the pressure exerted by investor decisions are the pressures exerted by the actions of consumers and interest groups. In the past decade, the concern for human rights came more fully into focus as an issue that can influence not only state practice, but also the actions of corporations. Western corporations are sensitive to accusations that their foreign suppliers or subsidiaries engage in unfair labor practices or damage the environment. This is especially true for those corporations that sell their products to the public in the West and whose brands are therefore dependent on the good will of ordinary consumers. To be sure, human rights concerns do not predominate, but they are increasingly important as corporations decide where to invest in the developing world.

The second claim I make is that China's recent investments in Africa amount to unconditioned wealth, which raises a real risk that their effect on local populations will, in the end, be negative. This is a stronger claim than the argument that unconditioned wealth will not have positive effects. I show that unconditioned wealth, whether it comes in the form of unencumbered investment from China or from the discovery of a valuable natural resource, can create or exacerbate incentives that increase the prospect of human rights abuses. Unconditioned wealth can lead governments to consolidate access to the resource; centralize decision making regarding the distribution of rents; consume the resource too quickly; and fail to respond to the concerns of citizens, choosing instead to purchase support by, for example, expanding public sector employment. Of course, not all of the incentive-based problems with China's investments in Africa are because of unconditioned wealth. Some of the problems are due to the uneasy merging of political and commercial concerns.


21. There is now a cottage industry of interest groups that monitor and attempt to influence the behavior of Western corporations. See, e.g., Jill Gabrielle Klein, et al., Why We Boycott: Consumer Motivations for Boycott Participation, 68 J. MARKETING 92, 93-95 (2004) (surveying research findings suggesting reasons for consumer boycotts). For an extended treatment of this issue, see NAOMI KLEIN, NO LOGO 311-420 (2002) (describing activists' campaigns designed to affect the behavior of firms). Indeed, many Western corporations have concluded that it is in their interest to cultivate a reputation for social responsibility. See Paul A. Argenti & Bob Druckenmiller, Reputation and Corporate Brand, 6 CORP. REPUTATION REV. 368, 372-73 (2004) (presenting results of qualitative empirical research suggesting that corporate managers seek to create socially responsible identities for their brands).

22. See discussion infra Part IV.
Beijing designs its investments to serve several purposes: for example, it needs oil for both commercial and strategic reasons. It is therefore willing to invest in projects that are unlikely to generate a financial return because it is satisfied with a strategic return. Governments receiving such investments face pressure only to deliver what Beijing seeks—access to resources. Importantly, the government receiving the investment does not face the various (and strong) pressures that would come if loans were market loans. I show that, once relieved of such market pressure, host governments are freed of the discipline that the market exerts; the results can be ill-advised investments, abuse of local populations, or a variety of other socially-negative outcomes.

This Article proceeds in four parts. In Part II, I describe China's increasing activity in Africa and its implications. In this part, I first trace the recent history of China’s investments in Africa, and I then present more detailed studies of China’s interaction with four states—Angola, Sudan, Zambia and Zimbabwe. Although it is too soon to draw definitive conclusions about the social consequences of China’s investments, the early results are decidedly mixed. By providing financial support to regimes that would otherwise be isolated because of their behavior, China's investments have the potential to undermine respect for human rights. In Part III, I survey and critique the conventional accounts of the effects of wealth on state behavior, which come from macroeconomics and political economy.

Parts IV and V are the heart of the Article. The most useful analysis of the association between wealth and regime behavior comes from the "resource curse" literature, the goal of which is to explain the association between resource-rich economies and apparent lags in economic and social development. My focus is different, but the literature provides important evidence nonetheless. I explore the ways that inputs of capital or other support for states can affect the behavior of those states. Put another way, I aim to identify what it is about wealth—including income from natural resources, unconditioned financial support from other states, or aid from multilateral agencies—that appears to be linked to economic and social ills, and assess whether it is possible to generalize from these factors to other kinds of income. To address this question, I first lay out the empirical evidence demonstrating the relationship between resource-dominated economies and social ills. Then I consider what the empirical evidence shows about the causal pathways that link human rights and a government’s access to funds. I argue that governments that receive streams of funds without the right mix of attached conditions have strong incentives to behave in abusive or undemocratic ways, with few checks on such behavior.

In Part V, I argue that there are mechanisms available to mitigate the potential harms of unconditioned wealth, including China's investments in Africa. When political power is the primary avenue to wealth, politicians have a strong incentive to maintain power in any way they can. As with resource wealth and much foreign aid, this can mean that African states put wealth to politically productive uses, but not socially productive uses. China's
investments are explicitly unconditioned: Chinese investors do not tell those receiving the investments or aid how to use the wealth. This means that those who control the wealth need not answer for its use. There is nothing to counter the incentives that may exist to put the wealth to unproductive uses, in contrast to market conditions, under which many actors have a strong financial incentive to monitor the uses to which wealth is put. I conclude by proposing several specific mechanisms by which it might be possible to strengthen both market forces and political accountability in order to reduce the likelihood that China’s investments in Africa will create the kinds of social problems that other investments on the continent have created. My policy proposals fall into two broad categories. In the first, I identify changes in the law that might affect the incentives of market participants to closely monitor China’s investments in Africa. In the second, I suggest ways that policymakers might exploit some common behavioral biases to increase the value that citizens attach to unconditioned wealth.

II.
WEALTH AND REGIMES: THE CASE OF CHINA IN AFRICA

In November 2006, heads of state and foreign ministers from 48 African countries gathered in China for a two-day summit on trade and investment. At the end of the summit, Chinese President Hu Jintao promised that his country would double aid to Africa by 2009 and would make available at least $5 billion in loans and credits. The China-Africa summit was only one of a series of steps that China has taken to increase its investments and influence in Africa. Trade between China and countries in Africa increased from $10 billion in 2000 to approximately $55 billion in 2006. By the start of 2006, Chinese companies had opened 750 businesses in Africa worth at least $1 billion. Although Beijing’s investments have mostly been in service of its search for raw materials to fuel its booming economy, it has also invested in telecommunications, infrastructure projects like roads and bridges, and is even building a new conference hall for the Africa Union.

In this Part, I provide an overview of the scope and structure of China’s investments in Africa. China’s interest in Africa is not new, and its stated

25. David White, A Spectacular Resurgence: The China Factor, FIN. TIMES, Nov. 21, 2006, at 2 (reporting trade in 2000 was approximately $10 billion); Richard McGregor & Andrew Yeh, China’s path through Africa not all Smooth, FIN. TIMES, Jan. 31, 2007, at 7 (reporting trade in 2006 was $55.5 billion).
27. See White, supra note 25, at 2.
approach to investment has been consistent over time. But the magnitude of Chinese investment in Africa is new, and the speed with which it has become a major investor and strategic player is little short of stunning. Because China's engagement with Africa has increased so rapidly that it has, until recently, largely escaped notice, it is useful to sketch out just what China has done in Africa. After the overview, I examine four short case studies, of Angola, Sudan, Zambia, and Zimbabwe, to illuminate the ways that China's investments and policies have changed the incentives and constraints facing potential violators of human rights.

A. China's Strategic Interest in Africa

China's recent record of economic growth has been undeniably spectacular. Between 1975 and 2004, China's gross domestic product grew at an annual rate of 8.4 percent.\(^{28}\) Its growth rate is even higher since 1990.\(^{29}\) China now has the sixth largest economy in the world and has added 100 million workers to the world labor market.\(^{30}\) Much of China's economic growth has come from exports, which are responsible for China's enormous trade surplus and substantial reserves of foreign currency.\(^{31}\) Paralleling China's economic growth, the growth in China's oil imports, particularly from Africa, has been dramatic. In recent years, these imports "have been increasing at an annual compounded rate of 30 percent."\(^{32}\) There is little reason to believe that China's demand for oil will decrease any time soon. In 1985, China was the largest oil exporter in East Asia;\(^{33}\) today, China is the second-largest importer of oil in the world.\(^{34}\)

The most common explanation for China's increasing interest in Africa is that China is desperate to secure a steady supply of the raw materials needed to sustain its remarkable economic growth. Although other important factors are at work, China's hunt for natural resources, oil chief among them, is one of the primary factors driving its political and economic strategy, particularly in the


\(^{29}\) Id.


\(^{31}\) See Geoff Dyer & Sandeep Tucker, In Search of Illumination: Beijing's “Go Out” Call is Giving Enterprises the Knowhow They Need, FIN. TIMES, Dec. 4, 2007, at 13 (noting that overseas investment from China "nearly doubled" in 2007, due in part to China's $1.5 trillion foreign currency reserves).

\(^{32}\) BROADMAN, supra note 9, at 82. Oil made up 62 percent of Africa's total exports to China in 2004. Id. at 81.

\(^{33}\) David Zweig & Bi Jianhai, China's Global Hunt for Energy, 84 FOREIGN AFF. 25, 25 (2005) ("Twenty years ago, China was East Asia's largest oil exporter. Now it is the world's second-largest oil importer; last year, it alone accounted for 31 percent of global growth in oil demand.").

\(^{34}\) Id.
developing world. Beginning in earnest near the time it shifted from a net exporter to a net importer of oil around 1993, China has pursued a bold and sophisticated policy of reaching out to countries in Africa in ways that advance Beijing's interests and are attractive to many African governments. Although there is disagreement about when China's relationship with Africa began, there is substantial evidence that trade between the two regions was fairly regular by the 10th century. Modern China began to establish relations with African states in 1956 and today has relations with 48 out of 53 African states. Although the bases of Beijing's approach to Africa have shifted over the years, today the relationship is friendly and driven by mutual economic and strategic needs.

Beijing's primary incentive to engage with Africa is its need for oil and other natural resources, but there are important secondary considerations. For example, Beijing faces a problem that many African states have never faced: it has too much money, and it needs a place to invest this surplus. China's economic boom has produced trade surpluses on a scale not seen before, and Beijing is beginning to move aggressively to harness this liquidity in the service of some of its strategic objectives. Africa presents a fertile, if risky, environment for investment because there is relatively little competition from the West. Another motivation for China's interest in Africa is its desire to increase its strategic profile. Particularly since the wave of criticism it faced after the Tiananmen Square massacre, China has sought to broaden its circle of allies and trading partners beyond the traditional Western powers.

Several other factors have also contributed to China's increased interest in enhancing its presence in Africa. China is a relative late-comer to the strategic competition for petroleum products. By the time that China's economic growth had made the search for oil into one of China's principal strategic interests, the U.S., the U.K, and France had secured so many long-term oil exploration and


36. See Gao Jinyan, China and Africa: The Development of Relations over Many Centuries, 83 Afr. Aff. 241, 241 (1984) (noting that historians "have tried to establish when China started to have contact with Africa," but "so far opinions differ").

37. See John Reader, Africa: A Biography of the Continent 328-29 (1997) (noting that "Arab reports and Chinese trade figures indicate that large quantities of African products were reaching China by the tenth and eleventh centuries—almost certainly via India"). Apart from overland trade, there is evidence that Chinese ships reached the shores of what is today Kenya, Somalia and Tanzania in the 15th century and established relations with local leaders in Mogadishu, Malindi, Mombasa, Zanzibar, Dar es Salaam and Kilwa." Id. at 329.

38. See Jinyan, supra note 36, at 248 (noting that "Egypt became the first African country to establish diplomatic relations with China in 1956").

exploitation deals that there was little room left for China. This forced China to search for oil in places that companies from other states would not go (or from which they had withdrawn or worked under strict conditions), such as Sudan and Angola. There is another related strategic factor. By the time China entered into the search for oil in earnest, the U.S. and its allies held effective control over most of the shipping lanes by which China would transport oil from source countries to the Chinese mainland. Without having either control of shipping lanes or access to oil in locations which facilitated the use of alternative shipping routes, China could have found itself short of oil in the highly unlikely event the U.S. or its allies decided to close the shipping lanes under their control.

Another important factor in China’s recent surge in investment in Africa is that Chinese firms have been able to pursue deals for resources with much higher degrees of risk than have Western firms. The Chinese government provides insurance to Chinese firms so long as those firms act in ways that are consistent with China’s national interests. In contrast, most Western firms must purchase insurance products in the market. This means that Chinese firms engaged in the search for resources (the overwhelming majority of which cooperate with the Chinese government) can, at the same level of cost, pursue riskier projects than similar Western firms.

B. African Receptivity to China

Just as the reasons for China’s interest in Africa are complex, so too are the reasons that so many African leaders are receptive to Beijing’s entreaties. First,

40. See Hong Zhao, China’s Oil Venture in Africa, 24 E. ASIA 399, 402 (2007) (arguing that China has developed oil resources in Africa because it “perceives the current oil production order and partnerships as entrenched ... U.S., Japanese and European companies have already forged relationships with key producing countries,” leaving little room for Beijing).

41. See Ian Taylor, China’s Oil Diplomacy in Africa, 82 INT’L AFF. 937, 950 (2006) (noting that “during the late 1980s and early 1990s, western oil companies were forced to scale down operations in Sudan because of human rights violations and the civil war, China stepped in to displace them”).

42. See Dennis Blair & Kenneth Lieberthal, Smooth Sailing: The World’s Shipping Lanes are Safe, FOREIGN AFFAIRS, May 2007, at 7 (arguing that only the United States has the capacity to close the shipping lanes used to transport oil); David Lei, China’s New Multi-Faceted Maritime Strategy, 52 ORBIS 139, 143-44 (2008) (describing debates within China’s military establishment regarding the protection of shipping lanes).

43. See BROADMAN, supra note 9, at 272 (describing support provided by the government of China for Chinese investments in Africa).

44. To be sure, Western governments provide some support for companies doing business in the developing world. In contrast to Chinese support, however, Western agencies impose social and environmental conditions on their support, which increases the cost. For a more comprehensive analysis of the varied effects of government-sponsored support for development, see Eisuke Suzuki, Bi-lateral Policy Orientation in the Multilateral Development Policy: A Challenge for the China Exim Bank and its Accountability, 6 CHINESE J. INT’L L. 127, 130-32 (2007) (describing differences in conditions associated with Chinese and Western support for overseas investment).
China can provide much-needed funds for development (or simply to avoid deepening impoverishment). This is important because many African states are in need of investment and aid, and, (promises to the contrary notwithstanding) because many Western countries are providing relatively less aid or providing aid in ways that are less appealing to recipient countries. Second, China’s approach to providing aid or investment is a congenial one to many African leaders. China generally requires only that the recipient country refuse to recognize Taiwan. Beyond this, China’s approach is, to many African leaders, refreshing: it is pure capitalism, without attempts to enact social or political changes through the pursuit of wealth.

The evidence of African poverty and growth rates leaves little room for doubt about the need for substantial financial assistance and improved terms of trade. What these statistics do not explain is why Chinese assistance would be preferred over assistance from other sources. The reasons are many, centering on China’s policy of separating business from almost all other concerns. China has long claimed to disclaim any attempt to influence the domestic affairs of its trading partners, and its current approach toward Africa is consistent with this. In its recent African policy paper, China promises to be guided by “[s]incerity, equality and mutual benefit, solidarity and common development” in its relations with states in Africa. At the level of theory, African states interpret the fact that China privileges sovereignty over considerations such as human rights or development as Beijing’s recognition that African states are truly free and independent. For years, African leaders have chafed at the broadening range of conditions attached to aid or loans. During the Cold War, the conditions were relatively simple: states received support so long as they aligned themselves with the donor country. As the Cold War ended and in the years since, the conditions attached to loans, grants, and trade agreements have become more burdensome to recipient states. No longer is it enough to remain loyal to the donor. Conditions now typically reach much further into the country’s affairs; dictating, for example, how much a state could spend on social services or education. Not surprisingly, as conditions became more intrusive, recipient states became eager to identify other sources of financial support.

45. See Large, supra note 39 (noting that China engages with those states that do not recognize Taiwan).
46. See China’s Africa Policy, supra note 10.
47. See Taylor, supra note 41, at 939-41 (arguing that many African leaders resent Western criticism of their regimes and welcome China’s view that sovereignty and economic development should trump political or civil rights).
48. See, e.g., STEVEN RADELET, CHALLENGING FOREIGN AID 4 (Center for Global Development 2003) (arguing that aid during the Cold War was motivated by security concerns: “No one seriously believed that Zaire’s Mobutu Sese Seko was using American largesse to vaccinate children and train teachers.”); JOHN D. MONTGOMERY, THE POLITICS OF FOREIGN AID 40-43 (1963) (describing Burma’s movement from U.S. ally (and aid recipient) to Communist ally (and aid recipient) and back).
49. See Steven R. Ratner, Corporations and Human Rights: A Theory of Legal Responsibility,
China’s approach, though often encapsulated in the shorthand “non-interference,” is actually broader. One important aspect is that China has proven willing to fund large-scale projects such as conference centers, soccer stadiums, and the like, that are only loosely connected to economic development. Such projects are a tangible demonstration of respect that can pave the way for other projects and can differentiate China from Western governments. Another aspect of China’s approach is what some call “prestige diplomacy:” granting formal state visits to the leaders of recipient countries or paying high-level visits to such countries.

Of course, African states are eager to partner with China for reasons other than its non-interference policy. For many African leaders, China’s approach means that it is simply easier to work with China than it is with the West. The attitude of Sierra Leone’s ambassador to China is typical:

We like Chinese investment because we have one meeting, we discuss what they want to do, and then they just do it.... There are no benchmarks and preconditions, no environmental impact assessment. If a G8 country had offered to rebuild the stadium, we’d still be having meetings about it.

It should come as no surprise that states eager to develop would embrace such an approach. Put another way, it is perfectly rational for a state to select the partner that imposes the lowest costs; other things equal, a less burdensome procurement process is more appealing than a more burdensome one.

Another important consideration is that deals concluded with China provide more opportunities for leaders to enrich themselves than do deals with the West. This plays out in two distinct ways. First, China does not require recipient countries to implement the kinds of anti-corruption measures that many Western governments and institutions require. These measures can be specific to the project, such as those requiring Chad to account for its oil revenues, or

111 YALE L. J. 443, 458 (2001) (arguing that after the end of the Cold War, “many developing-world states could no longer count ... on economic aid from one side of the iron curtain or the other[,] ... [a]s a result, the lure of foreign investment became even greater”).

50. Whether China’s policies actually amounted to non-interference is a separate question. For example, when Zhou En-lai visited Africa in 1963 and 1964, he repeatedly stated that “Africa is ripe for revolution.” MARTIN MEREDITH, THE FATE OF AFRICA 148 (2005). From the perspective of many in China, this meant that China was committed to helping Africans in their struggle for self-determination. See, e.g., Jinyan, supra note 36, at 249 (arguing that Chinese policy reflected the belief that “China has the obligation to help the African people to achieve and defend their national independence”). In contrast, many Africans, at least in the early days of modern China’s engagement in Africa, feared that China intended to engage in “feat[s] of subversion” in Africa. MEREDITH, supra this note, at 148.

51. See Taylor, supra note 41, at 948-49 (arguing that China’s unconditioned financial assistance encourages the creation of “white elephant” projects instead of productive investments).


54. See, e.g., Jeremy H. Keenan, Chad-Cameroon Oil Pipeline: World Bank & ExxonMobil in
general, such as those required by the E.U. for its African and Caribbean trading partners. For China, the project is paramount; what the recipients of its trade or aid do with the money is not the primary concern. This means that projects are relatively easier to pursue with China than would be the case if the recipient did business only with Western institutions. Second, China does not appear to monitor whether individual leaders have inappropriately enriched themselves with funds from a Chinese project. China’s approach not only provides potentially corrupt leaders more opportunities to enrich themselves, it also does not hold accountable those leaders who do so. The result is that elites can enrich themselves directly or protect their positions of power by doling out the proceeds of improper deals without fear of outside scrutiny.

C. Short Studies: Angola, Sudan, Zambia & Zimbabwe

A variety of principles and objectives, including non-interference, the pursuit of resources, and a preference for economic development over other objectives have shaped China’s overall strategy in Africa. But China’s approach has not been monolithic. The particulars of its policy have varied along with its trading partners. In this Part, I illustrate China’s strategy through four short studies of China’s most prominent trading partners. In addition, I draw two important clusters of lessons. First, I identify some of the ways that China’s presence has changed the incentives that governments face in the developing world. In addition, I identify the ways that China’s practices are likely to become increasingly common as more states find themselves competing for resources and more investors find ways to involve themselves in riskier and more potentially-rewarding projects. Three of the examples, Angola, Sudan,
and Zimbabwe, show the ways that Chinese support has emboldened rogue regimes and undermined local attempts to hold their governments accountable. The Zambia example shows the ways that Chinese investment can affect the investment decisions made by corporations from other states. In addition, the Zambia example shows how investment from China can undermine local working conditions.

1. Angola

After almost three decades of civil war, Angola has been relatively peaceful since 2002. During that time, the competition for Angola’s oil has become increasingly intense. The country is now the largest supplier of oil to China, and, in four years, Angola is expected to produce as much oil annually as Kuwait.\(^59\) Angola’s economy is almost entirely dependent on oil revenues. For example, in 2005, the oil sector “accounted for more than 52 percent of GDP, 78 percent of government revenues and 93 percent of exports.”\(^60\) In 2006, Angola earned more than $30 billion from oil exports,\(^61\) yet more than two-thirds of the population lived on less than $2 per day.\(^62\) And Angola’s reputation for corruption and inefficiency is almost unparalleled. Multilateral organizations like the Organization for Economic Cooperation and Development, non-governmental organizations like Transparency International, and state governments agree that Angola is one of the most corrupt business environments in the world.\(^63\) China’s involvement in Angola must be understood against this complex backdrop of resources, war, corruption, and poverty. China clearly is not to blame for Angola’s economic problems. But China’s recent involvement has not made life appreciably better for average Angolans, and it has changed the set of incentives facing Angola’s leaders as they decide how to spend their country’s vast oil wealth.

From 1997 through 2002, more than $4.2 billion, mostly oil revenues, disappeared from Angola’s public accounts.\(^64\) In response, the IMF increased its

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59. See Jad Mouawad, Nowadays, Angola is Oil’s Topic A, N.Y. TIMES, Mar. 20, 2007 (estimating that by 2011, Angola will produce 2.6 million barrels per day, the same as Kuwait).


61. Mouawad, supra note 59.


63. See TRANSPARENCY INTERNATIONAL, GLOBAL CORRUPTION REPORT 330 (2007) (indicating that Angola is one of the most corrupt countries in the world based on assessment of the level of corruption in 163 countries).

64. HUMAN RIGHTS WATCH, SOME TRANSPARENCY, NO ACCOUNTABILITY: THE USE OF OIL REVENUE IN ANGOLA AND ITS IMPACT ON HUMAN RIGHTS 36, table 8 (2004). The Human Rights Watch report was based on data uncovered by the IMF during its 2002 and 2003 consultations with Angola. Id. at 36 n.76.
demands for more transparency and better management of public resources. In 2004, China came forward with an aid package that approximated the IMF package, but which permitted Angola to avoid the transparency and accountability conditions that would have accompanied IMF funds. China agreed to provide Angola with a $2 billion line of credit, backed by oil revenues. In addition, Angola's state oil company arranged for a similar line of credit with a lender with links to China, thereby avoiding the transparency requirements that Western banks would have imposed. Although there is some evidence that Angola is slowly beginning to modify its fiscal policies, it is clear that Angola’s leaders have not abandoned their use of the oil revenues as private funds.

This short example highlights the role that seemingly obscure financial issues can have in influencing the promotion and protection of human rights. In Angola, seven out of ten people live on less than $2 per day. This has not changed appreciably, even with the influx of oil money. To be clear, my argument is not merely a criticism of democratically-made decisions as to the best way to distribute government resources. Angola shows—more clearly than almost anywhere in the world—the connection between extreme poverty and human rights. Poor people in Angola lack access to clean water, adequate sanitation, and reliable supplies of food. The government continues to subject people who criticize the government to arbitrary arrest and harassment. Meanwhile, the government has spent the majority of redevelopment funds on the repair of the railroad that runs from the port city of Benguela to the main

66. See John Reed, Angolan Oil Loan Likely To Raise Transparency Issues, FIN. TIMES, Oct. 11, 2005, at 13 (“China has proved willing to lend to Angola where the IMF has hesitated. Last year China’s Eximbank approved a Dollars 2bn loan to rebuild infrastructure devastated or neglected during the country’s long civil war”).
67. Id. at 13.
69. See Angola: Acting Tough, ENERGY COMPASS at 1 (Mar. 15, 2007) (noting that the Angolan government is attempting to dictate more favorable terms with its lenders due to increases in oil revenues).
70. WORLD BANK, supra note 62.
71. Id. at 112 (describing Angola’s oil economy as an “enclave” from which resources do not reach most poor people).
72. For example, according to the United Nations Development Program, life expectancy in Angola is just over 41 years, half of all Angolans lack access to clean water, and almost one third of children under the age of five are underweight. See United National Development Program, Angola: The Human Development Index - Going Beyond Income, http://hdrstats.undp.org/countries/country_fact_sheets/cty_fs_AGO.html.
73. See, e.g., HUMAN RIGHTS WATCH, WORLD REPORT 76-81 (2008) (describing ongoing political violence, press restrictions, violence against women, and other issues in Angola).
mining area almost 800 miles away. These spending decisions are not the product of democratic choice. Indeed, since it began to receive substantial oil revenues, the government has repeatedly postponed elections. In the end, China’s willingness to fund the Angolan government without the kinds of transparency or accountability conditions that other international lenders would require is in China’s strategic interest because China is able to ensure access to oil for which it is desperate. The cost, however, is borne by the people of Angola. China’s assistance permitted the Angolan government to forego IMF assistance, which may have contributed to the development of useful governance norms and created an incentive for the Angolan government to change its behavior.

2. **Sudan**

Of all its activities in Africa, China’s relationship with Sudan has received the most scrutiny. As with Angola, the current situation in Sudan has its roots in the country’s complicated history. Nonetheless, China’s actions in Sudan are instructive. Recently, Sudan has gained notoriety for the ongoing genocide in the western province of Darfur, but there have actually been two distinct conflicts there. For much of the past two decades, the Arab government of Sudan engaged in a war with black inhabitants of South Sudan, far from the Darfur region. China played a role in this war by selling arms to the Sudanese government, but its role increased dramatically in the 1990s. In 1996, the Chinese national oil company bought into a consortium of oil companies to exploit oil fields in South Sudan. When oil revenues began to increase substantially in 1999, the Sudanese government stepped up its purchases of weapons and took a more aggressive stance against the Southern rebels. Despite

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74. See China’s Resource Politics Wins Friends in Africa, ENERGY ECON. at 31, July 2006 (noting that the work on the railway from Benguela to Angola’s border with the Democratic Republic of Congo is financed by a $2 billion loan from China’s Eximbank).

75. For example, in its annual report on human rights, Human Rights Watch concluded as follows regarding Angola:

[Its] increasing international role, along with major investment and trade opportunities mainly from the oil, diamond, and reconstruction sectors, has helped to insulate Angola from criticism on good governance and human rights. The World Bank and other donors have attempted to make lending to Angola conditional on transparency and good governance, but the government has been able to avoid these conditions by obtaining large unconditional loans from China.

HUMAN RIGHTS WATCH, supra note 73, at 81.

76. See JOHN GHAZVINIAN, UNTAPPED: THE SCRAMBLE FOR AFRICA’S OIL 280-81 (2007) (reporting that from “1956 to 1972, and again from 1984 to 2005, the southern states of Sudan were the scene of one of Africa’s most brutal and intractable civil wars, as the mostly black animist and Christianized South fought against various Arab-and-Muslim-dominated governments in Khartoum.”).

the potential for immense profits, Talisman, a Canadian oil company, sold its right to exploit oil reserves in South Sudan because of human rights concerns (and pressure from non-governmental organizations).\(^7\) Since then, China has only increased its involvement in Sudan. It has continued to sell arms to the Sudanese government, some of which have been used to drive indigenous black southerners from their land to clear a path for oil pipelines and new oil fields.\(^7\) Separately, China bought into a second consortium to exploit oil fields in Darfur.\(^8\) As Western corporations have moved away from Sudan, China has moved closer.

China’s approach in Sudan again shows the link between human rights and finance. China’s support has allowed Sudan to avoid the sanctions that would typically accompany the kind of human rights abuses that have occurred in Darfur and elsewhere in the country. States that engage in similar behavior have found themselves with few allies and little access to funds, particularly for weapons.\(^8\) China’s involvement has insulated Sudan from these effects. Second, one reason that China has been attracted to Sudan is that it faces less competition there than it would in other regions. Because most Western oil companies will not work in Sudan due to reputational concerns, Chinese firms face a much less competitive environment.\(^8\) In addition, to the extent that working in a conflict area imposes increased costs on its corporations, China can offset these costs through its arms sales to the Sudanese government, which the government uses to continue the conflict. China therefore has no economic incentive to end the genocide—it has Sudan’s oil fields to itself, and it earns money by selling arms to the Sudanese government. Taken together, these factors have changed the set of options confronting the government of Sudan and reduced any incentive to stop abusing its people.

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78. See Talisman’s Slow Motion Pull-Out, AFR. ENERGY INTELLIGENCE, March 13, 2002 (describing Talisman’s efforts to find a buyer for its stake in the Sudanese oil fields); Talisman Could Face Trial, AFR. ENERGY INTELLIGENCE, Apr. 2, 2003 (describing efforts by Sudanese and Western non-governmental organizations to hold Talisman legally accountable for the violence in Southern Sudan).

79. See Karl Vick, Oil Money is Fueling Sudan’s War: New Arms Used to Drive Southerners from Land, WASH. POST, June 11, 2001, at A1 (reporting that oil revenue has been used by the government of Sudan to purchase weapons used to displace the local population in South Sudan).

80. See Goodman, supra note 77, at A1 (reporting that China “owns most of a[n oil] field in southern Darfur”).


82. See Goodman, supra note 77, at A1 (quoting a Chinese government analyst who stated that because “China confronts foreign competition,” its “companies must go places for oil where American [and] European companies are not present. Sudan represents this strategy put into practice”).
3. Zambia

Any discussion of Chinese investment in Africa must consider the potentially positive economic effects of investment, including the creation of jobs, the spread of technology, and the long-term ways that competition can benefit local businesses by sparking innovation and increasing efficiency. Zambia's experience with investments from China illustrates the complicated nature of this point. When the Chinese economy began to boom in the 1990s, it looked abroad for investment opportunities. Zambia was a natural and receptive target, owing in large part to China's role in the creation of a railroad linking Zambia's copper mines to a port in Tanzania. In the early 1970s, Chinese engineers constructed the Tazara Railway, which ran from Zambia's copper belt to the Indian Ocean port of Dar-es-Salaam and allowed Zambia to export copper without traveling through the war in what was then Rhodesia. And today, China's investments in Zambia have contributed to substantial growth in several economic sectors.

Compared with Sudan, China's involvement in Zambia is much less well-known in the West, but it illustrates the complicated nature of China's investments in Africa. As China's economy grew in the 1990s, its need for copper grew substantially, and it invested in several moribund Zambian copper mines, including one in Chambishi, in Zambia's so-called copper belt. At the time, Zambians were eager for the business and the promised investments in infrastructure. Local enthusiasm began to wane as it became clear that the Chinese investors intended to fill the best jobs with Chinese workers. Then, in 2005, an explosion at the mine killed 46 Zambian workers, many of whom were initially not identified because the mine operators did not keep records of local workers. Little more than a year later, six Zambian workers at a Chinese-owned mine were shot after a demonstration protesting the alleged non-payment of wages. These incidents prompted protests in Zambia and became an issue in the 2006 presidential election in which the challenger argued that, if elected,
he would restructure Zambia’s relationship with China.\textsuperscript{88} Chinese officials stated that they would withhold further investments until after the election, which the China-friendly incumbent won.\textsuperscript{89} After the election, China’s president announced that China would forgive approximately $211 million of Zambia’s debt to China.\textsuperscript{90}

Zambia’s experience illustrates an important issue. When China began to invest in Zambia, it signaled to other investors that Zambia’s mining sector was a potentially lucrative investment. To be sure, Zambia’s economic health has long depended on copper mining,\textsuperscript{91} but China’s interest helped spark renewed interest in several dying mines. For example, an Indian group bought one major mine, and Australian investors bought into another.\textsuperscript{92} The important point is that as Western firms are forced to compete with Chinese firms with a higher tolerance for risk, Western firms must increase their tolerance for risk or face a loss of market share or access to natural resources. Such competition can bring economic benefits to the host country, but these benefits come at a social cost for the people in the host country in the form of dangerous labor conditions, environmental degradation, and the like.

4. Zimbabwe

China’s relationship with Zimbabwe’s president, Robert Mugabe, began even before Zimbabwe gained independence. In the war for independence, China backed Mugabe’s faction over a rival group in a black-opposition power struggle.\textsuperscript{93} After Zimbabwe’s independence, China remained a loyal ally. That relationship grew in the past decade as Zimbabwe faced sanctions from the West for a variety of human rights abuses. The most prominent abuse was an eviction campaign in 2005. Called “Operation Restore Order” by the government, the program displaced as many as 700,000 citizens as the government razed homes and businesses.\textsuperscript{94} In light of this and many other problems, Western
governments imposed sanctions on Zimbabwe and the IMF suspended its operations there.

Without this support, and facing inflation of upwards of 1000 percent, Zimbabwe turned to China for assistance as part of its “Look East” policy. The new strategy entailed encouraging investment from China, including granting Chinese firms substantial stakes in formerly state-owned firms. Many of the agreements are barter deals: China lends money or invests in a firm in exchange for natural resources. Faced with a Western arms embargo, Zimbabwe purchased military aircraft from China. The Look East policy even extends to education. Zimbabwe’s public universities are working with Chinese officials to begin developing new required courses in Chinese history and language. China’s support of Zimbabwe offers perhaps the starkest example of the social consequences of unconditioned financial support. Without China, there is almost no way that Zimbabwe’s president could have remained in power.

III. CONVENTIONAL ACCOUNTS OF STATE BEHAVIOR AND UNCONDITIONED WEALTH

Are states sensitive to the source of their wealth? Does it matter whether a state receives the bulk of its income from taxes on goods produced domestically, or from oil revenues, or in the form of aid from other countries? It is true, of course, that most states in the developing world derive revenue from these and many other sources. And it is likely a fool’s errand to attempt to specify any single factor as the sole or primary reason that any government behaves as it does. Despite these limitations, there is evidence that the source of a regime’s wealth might well affect human rights practices in the country. These issues have taken on increasing importance with China’s recent investments in Africa because they are largely devoid of the conditions that historically have accompanied foreign investment or assistance. In this Part, I start by assessing


96. See In Brief: Zimbabwe, NEW AFR., July 2006, at 27 (describing a deal in which China provided “1,000 Chinese buses in return for a 75% share in Zimbabwe’s urban transport sector”).


the effect of resource wealth on regime behavior. There is a well-developed economic literature suggesting that rapid influxes of wealth from natural resources can have a profound effect on the domestic economy of a state. Moreover, according to a political economic approach, there is increasing evidence that resource wealth can contribute to a weakening of democratic institutions, an increase in official corruption, and a deterioration in human rights practices. I then consider the effects of foreign aid, which largely parallel those of resource wealth. In the end, this survey of the literature is important to my argument because it helps frame the likely effects of China's investments in Africa.

A. The Macroeconomic Approach: The "Dutch Disease"

Economists have long noted that rapid infusions of wealth from foreign sources such as remittances from colonies or earnings from exports can disrupt the domestic economy. Known variously as "the Dutch disease" or the resource curse, the basic economic analysis looks at the effect that a rapid expansion in the export of natural resources has on a domestic economy. A natural resources boom can affect a domestic economy through two closely-linked causal pathways. First, in a typical domestic economy, one reason that goods manufactured for export are valuable is that they generate foreign exchange, which can be used to import goods from other countries. But if, for example, natural gas is discovered and begins to generate significant amounts of foreign exchange, there is no longer a need to manufacture other goods for export because the domestic demand for foreign currency has already been satisfied. One consequence of this is to make products produced solely for the domestic market relatively more expensive and to suppress the profitability of goods (other than natural resources) produced for export. Put slightly differently, it is the effect of increased earnings from the sale of natural resources on demand that matters. Assume that the demand for some goods

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100. See, e.g., JAIME ROS, DEVELOPMENT THEORY AND THE ECONOMICS OF GROWTH 212-13, 392 n.1 (2000) (noting that the first example of what came to be known as the Dutch disease came from "the transformation of Spain into an importer of manufactures from, ironically, the Netherlands following the large inflows of gold and silver from its colonies in the New World").

101. The label "Dutch disease" appears to have appeared for the first time in the Economist magazine in 1977, in an article that sought to explain the contrast between the "external health and internal ailments" of Holland's economy. The Dutch Disease, ECONOMIST, Nov. 26, 1977, at 82.


103. See, e.g., Mohsen Fardmanesh, Dutch Disease Economics and the Oil Syndrome: An Empirical Study, 19 WORLD DEV. 711 (1991) (Arguing that an increase in "the relative price of non-traded goods increases the relative profitability of the non-traded goods sector and contracts the (non-resource) traded goods sector").

can be satisfied by importing them, but that other goods can only be produced domestically. In this case, the relative price of domestically-produced goods will rise, and draw capital and labor "into the non-traded goods sector and away from tradeables." 105 Thus, in a developed economy, the result of a natural resources boom on a domestic economy can be to raise the price of local goods and services and reduce the value of non-resource exports. 106

In a developing economy, the results can be similar, but, owing to structural differences between developed and developing economies, the causal pathways are somewhat different. A resource boom has at least two important effects. First, because of changes in the relative rates of return in different economic sectors, a boom can cause resources to shift from one sector of the economy to another—"the resource movement effect." 107 The second effect is the "spending effect," which occurs when increasing incomes lead to greater spending on some goods and services (primarily those associated with the booming industry), thereby increasing their price and causing the real exchange rate to rise. 108 Because the relative size of each effect is determined by other features of the economy, it is here that developing economies can differ from developed economies. The most important factor is whether the sector responsible for the boom—typically the exploitation of a resource such as oil or gas—depends mostly on resources that can be drawn from other sectors of the economy. 109 If, as is often the case, "the oil sector in a developing country is an enclave with respect to the rest of the economy (since it uses mainly imported materials and labor)," there is unlikely to be a significant shift of resources within the domestic economy. 110 On the other hand, the spending effect can be significant as goods with increased demand drive up the prices of one category of goods more than another. 111

B. The Political Economy Approach: The Resource Curse

The Dutch disease literature seeks to explain the relationship between resource endowments and economic outcomes. This macroeconomic model, though useful for explaining a number of cases, is limited because it does not account for those states with substantial natural resources that are growing. Put another way, why do some states with natural resources show remarkable

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105. Id.
106. Id.
108. Id.
109. Id.
110. Nancy C. Benjamin et al., The 'Dutch' Disease in a Developing Country: Oil Reserves in Cameroon, 30 J. DEV. ECON. 71, 72 (1989).
111. Id. at 73.
growth while others seem to suffer despite their riches? It is true, of course, that economic models are not laws of nature; that a model explains one situation does not mean it will explain every apparently similar situation. Even so, this model does not fully account for the robust empirical evidence showing that a reliance on natural resource exports, particularly oil, is associated with lower-quality governance, greater corruption, and a higher likelihood of civil war. First, as to governance, the strongest association is between a greater incidence of authoritarian governance and oil wealth. Even when controlling for a range of other factors that might influence governance, "oil does hurt democracy." What is more, "oil does greater damage to democracy in poor states than in rich ones," even if exports are relatively small. Next, as to corruption, there is evidence that natural resource wealth creates strong incentives for economic actors to bribe those who control access to the resources. Finally, the evidence of the association between resource wealth and civil conflict is compelling and appears robust across a number of contexts.

112. See Halvor Mehlum et al., Cursed by Resources or Institutions?, 29 WORLD ECON. 1117 (2006) ("Imagine that a valuable natural resources is suddenly discovered in both Afghanistan and Switzerland. What would be the economic consequences in each of the two countries be? Would the new wealth turn out to be a curse or a blessing?").

113. Michael L. Ross, Does Oil Hinder Democracy, 53 WORLD POL. 325, 356 (2001) (presenting evidence that wealth from other resources hinders democracy is not as strong as the evidence regarding oil, but the association still exists).

114. Id.

115. See Elissaios Papyrakis & Reyer Gerlagh, The Resource Curse Hypothesis and Its Transmission Channels, 32 J. COMP. ECON. 181, 188 (2004) (citing econometric analyses suggesting that "natural resources provide rents," "promote rent-seeking competition" and "induce economic agents to bribe the administration in order to gain access" to the rents). For illustrations of the phenomenon, see generally Nicholas Shaxson, Oil, Corruption and the Resource Curse, 83 INT'L AFF. 1123, 1124 (2007). Shaxson's examples demonstrate his larger claim, which is that "all the sub-Saharan African oil-producing countries, except Gabon and Cameroon, show below-average performance" on several leading measures of government performance and quality of governance. Id. at 1124.

116. There have been a number of theoretical and empirical assessments of the connection between resource wealth and civil conflict. See generally Paul S. Orogun, Plunder, Predation, and Profiteering: The Political Economy of Armed Conflict and Economic Violence in Modern Africa, 2 PERSP. ON GLOBAL DEV. & TECH. 283 (2003) (examining the links between natural resources and conflict in Liberia); Silje Aslaksen & Ragnar Torvik, A Theory of Civil Conflict and Democracy in Rentier States, 108 SCANDINAVIAN J. ECON. 571 (2006) (employing econometric model to assess the connection between resource abundance, political competition, and civil violence); Paivi Lujala et al., Fighting Over Oil: Introducing a New Dataset, 24 CONFLICT MGMT. & PEACE STUD. 239 (2007) (using new data regarding the abundance of resources, the location of resources within states, and the length and type of conflict to assess connection between resource wealth and civil conflict). These studies are generally consistent with each other, and show a connection between resource abundance and civil conflict. Perhaps the most reliable results come from a recent study by Michael Ross, who attempts to account for the flaws in earlier econometric studies. Based on his own analysis, Ross reaches two primary conclusions:

First, the likelihood of civil wars in countries that produce oil, gas, and diamonds rose sharply from the early 1970s to the late 1990s. So did the number of conflicts in which insurgents raised funds by selling contraband resources. Second, exogenous measures of oil, gas, and diamond wealth are correlated with the onset of civil war,
In addition to revenue from the sale of natural resources, an important source of revenue for many poor countries is foreign assistance. Wealthy countries provide vast amounts of money per year to poor countries in the form of grants and loans. In the past, much of this assistance was provided as loans that were, in theory, required to be repaid. More recently, foreign aid has come in the form of grants, with no obligation of repayment. The conventional approaches to aid had two broad justifications. First, aid is viewed as an instrument of foreign policy, designed to influence recipient states to behave in ways that benefit the donor state. On this account, aid can be either a carrot or a stick. Poor states know that if they wish to receive (or continue to receive) aid, they must behave in particular ways. Or, if states fail to behave, the donor state might withdraw aid (or provide it to the recipient’s strategic rival). The second conventional account of aid is that it is provided because of some moral obligation—wealthy states provide aid because they can and because poor states need it to reduce the suffering or increase the social welfare of their people.

The two most common measures of the effectiveness of aid are whether the aid contributed to economic growth or enhanced democracy. Most aid flows from wealthy democracies like the U.S., Europe, and Japan to poor non-democratic states. For donors, whether this aid was a wise use of funds was thought to depend, at least in part, on whether recipient states became more democratic and more market-oriented. The other most common test of the effectiveness of aid is whether the recipient state experienced economic growth. The evidence suggests that aid, at least as conventionally defined and delivered, has been largely ineffective on both scores.

and these correlations are robust along several dimensions.


117. *See, e.g.*, NICHOLAS EBERSTADT, FOREIGN AID AND AMERICAN PURPOSE 135 (1988) (arguing that the purposes of American foreign aid are “to augment American political power throughout the world” and to “support the postwar liberal international economic order that the United States helped create and is committed to preserving,” thus “this is not only a strategic goal but an objective dictated by U.S. moral and humanitarian concerns.”).

118. *See generally* JOHN DEGNBOL-MARTINUSSEN & POUL ENGBERG-PEDERSEN, AID: UNDERSTANDING INTERNATIONAL DEVELOPMENT COOPERATION 10-12 (2003) (surveying a variety of moral and humanitarian arguments used to justify the provision of foreign aid by wealthy donor states).


121. The literature on the relationship between development assistance shows the complicated nature of the question, and I do not purport to resolve it here. But even scholars who sharply disagree about many issues relating to the effectiveness of aid seem to agree that aid has generally
There is little consensus about why aid has been so ineffective at achieving donors' stated goals. Consider three hypotheses. One theory is that aid creates a type of moral hazard for recipients.\(^{122}\) There are many versions of this argument, but most suggest that recipients of aid use it not to open their economies or invest in their own people, but to entrench their own power through legitimate or illegitimate means.\(^{123}\) On this theory, aid is ineffective because donors are unable to control the uses to which recipients put aid, which allows recipients with a desire to stay in power to do so.\(^{124}\) Another element of this theory is that aid can undermine the recipient government's incentive to pursue policies that might improve social welfare but might simultaneously create political risk for incumbents. Aggressive tax collection and high tax rates are an example of such a policy.\(^{125}\)

A second explanation for the apparent ineffectiveness of aid is that aid too often comes with unhelpful requirements for its use. This theory holds that aid amounts to a form of centralized planning that can cause recipient states' bureaucracies to swell and can cause recipient economies to develop in ways that are responsive to the ill-conceived ideas of donors rather than the expressed

not been successful. Compare id. at 848 (concluding that "on average aid has had little impact on growth, although a robust finding was that aid has had more positive impact on growth in good policy environments"), and William Easterly et al., Aid, Policies, and Growth: Comment, 94 AM. ECON. REV. 774, 779 (2004) (criticizing Burnside & Dollar and finding virtually no positive effect from aid). One careful recent assessment of the impact of aid on economic growth concluded that, although many types of aid do not contribute to growth, short-term aid is associated with growth. See Michael Clemens et al., Counting Chickens When They Hatch: The Short Term Effect of Aid on Growth 40 (Ctr. for Global Dev. Working Paper, 2004). In that study, the authors divided aid into three categories, determined by where the aid was targeted and how it was used: emergency aid, long-term aid, and short-term aid. The authors found that short-term aid is correlated with economic growth. Id. at 3.

122. See, e.g., Karen L. Remmer, Does Foreign Aid Promote the Expansion of Government?, 48 AM. J. POL. SCI. 77, 82-83 (2004) (finding, based on empirical study, that a recipient state's "dependence [on foreign aid] is ... translated predictably into increased government spending over the long run").

123. See, e.g., Stephen Knack, Aid Dependence and the Quality of Governance: Cross-Country Empirical Tests, 68 S. ECON. J. 310 (2001) (presenting data showing that "higher aid levels erode the quality of governance, as measured by indices of bureaucratic quality, corruption, and the rule of law").

124. See, e.g., Philip R. Lane & Aaron Tornell, Power, Growth, and the Voracity Effect, 1 J. ECON. GROWTH 213 (1996) (arguing that aid and other sources of income can increase official corruption as politicians compete for control of rents); Alberto Alesina & Beatrice Weder, Do Corrupt Governments Receive Less Foreign Aid?, 92 AM. ECON. REV. 1126, 1127 (2002) (finding empirical support for the "voracity effect" by showing that "an increase in aid increases corruption").

125. There is some empirical support for this hypothesis. A recent study of the relationship between receipt of aid, expansion of the size of government, and local revenue generation such as taxation found that increases in aid are associated with increases in the size of the government. Remmer, supra note 122, at 82-83. In addition, the study found that aid "dependence is negatively linked with the growth of state revenues" generated locally. Id. at 87. This suggests that states that receive substantial amounts of foreign aid are less likely to attempt to generate revenue from local sources.
preferences of local consumers or other legitimate market forces. In contrast to the moral hazard theory, this account suggests that the problem is that the policy preferences of donors are followed too closely, thereby distorting the natural or appropriate development of the local economy.

Finally, some argue that aid has been ineffective at increasing social welfare because improving social welfare is not the true objective of the donor or recipient government. This approach assumes that states provide aid only to enhance their strategic positions and that recipient states are motivated mainly by a desire to retain power. In this scenario, neither the donor nor the recipient is actually committed to the purported aims of aid.

IV. THE EFFECTS OF UNCONDITIONED WEALTH

In this Part, I analyze the ways that unconditioned wealth can contribute to negative social outcomes. These issues are essential to my principal arguments: that Chinese investment in Africa amounts to unconditioned wealth, and that these investments may reduce rather than enhance social welfare. Wealth, particularly unconditioned wealth, creates strong incentives that affect the way political actors govern, manage state enterprises, and allocate resources. My analysis will necessarily focus heavily on the role of state institutions because, at their core, institutions are the mechanisms by which political incentives are channeled. At this level of generality, it should come as no surprise that states with strong institutions tend to handle resource wealth more effectively than states with weak institutions. The difficult task is to identify the causal pathways through which these incentives affect state behavior. After exploring causation, I build on this analysis to consider which conditions, if any, might be attached to unconditioned wealth to mitigate its possible negative effects.

126. The most forceful version of this argument comes in William Easterly's recent book The White Man's Burden. Easterly argues that the conventional Western approach to foreign assistance relies heavily on "planners," who impose conditions on aid recipients that stymie growth and undermine the recipients' incentives to develop their own economies. See WILLIAM EASTERLY, WHITE MAN'S BURDEN: WHY THE WEST'S EFFORTS TO AID THE REST HAVE DONE SO MUCH ILL AND SO LITTLE GOOD 4, 6-30 (2006).

127. See WORLD BANK, ASSESSING AID: WHAT WORKS, WHAT DOESN'T, AND WHY 16 (1998) (arguing that one of the reasons for the generally poor record for foreign assistance programs is that the "actual allocation of aid has often been influenced by the strategic interests of donors" which has meant that "much bilateral aid has gone to countries with poor management").

128. See, e.g., Mehlum, et al., supra note 112, at 1119 (surveying the resource curse literature).

129. At the outset, I should acknowledge that I do not attempt to determine whether resource wealth damages or strengthens institutions. I confine myself to considering the well-established association between weak institutions, weak economic and democratic outcomes, and resource abundance.
A. Governance Effects

One economic explanation for the resource curse is that resource wealth has the effect of reallocating domestic production in inefficient ways. On this account, the resource sector pulls capital and labor away from other sectors that might, over the long term, be more likely to improve social welfare or might improve social welfare for more people. Similarly, resource wealth can undermine the incentives that might produce responsive political institutions or efficient policies. Put another way, when domestic institutions do not create sufficient barriers to “discretionary redistribution” of resource rents and political power, the result can be a “redistributive struggle” in which “a greater share of resources ends up in nontaxable inefficient activities” than would be optimal.\(^{130}\) My focus here is not on the policies adopted to manage the wealth but on the ways that leaders and aspiring leaders attempt to gain and retain power.

When natural resources are described as a curse, one prominent reason is the effect that resource wealth seems to have on the way politicians act. There is no way to know how politicians respond to incentives. Consider first the most general issue: whether states that derive most of their income from oil revenues score worse on various measures of democracy. The available evidence suggests that resource revenues are associated with weaker democracies.\(^{131}\) More specifically, resource wealth does not appear to destroy well-functioning democracies.\(^{132}\) Instead, it appears to strengthen autocratic regimes and delay or prevent transitions to democracy that might otherwise be expected.\(^{133}\)

Unconditioned wealth shapes the incentives politicians face in three areas. First, if political power is the primary means to obtain access to wealth, politicians have a strong incentive to retain power for as long as possible. Consequently, unconditioned wealth creates an incentive to centralize control of access to the source of the wealth. Second, unconditioned wealth can lead politicians to cease to rely on taxes or other sources of revenue available only if

\(^{130}\) Aaron Tomell & Phillip R. Lane, *The Voracity Effect*, 89 AM. ECON. REV. 22, 23 (1999). Tomell and Lane argue that where political and legal institutions are weak, unconditioned wealth can produce “a more-than-proportional increase in redistribution” of wealth from resource rents. *Id.* at 42.

\(^{131}\) See Ross, *supra* note 113, at 346 (arguing that the regression results “suggest ... that a state's reliance on either oil or mineral exports tends to make it less democratic”). In the study, reliance on oil or mineral wealth was a measure of the export value of the commodity as a percentage of gross domestic product. *Id.* at 358. The extent to which a regime was democratic was measured using several indicators, mostly relying on data gathered by non-governmental organizations. *Id.*

\(^{132}\) See Jay Ulfelder, *Natural-Resource Wealth and the Survival of Autocracy*, 40 COMP. POL. STUD. 995, 996 (2007) (concluding, based on the empirical evidence, “that ... resource wealth has played a significant role in helping to sustain authoritarian rule in numerous countries that have never attempted democracy and in delaying a return to democracy in some countries that have”).

\(^{133}\) *Id.* at 1012 (“Other things being equal, autocracies that derive more of their national income from oil, natural gas, and other mineral resources are substantially less likely to transition to democracy.”).
the politician is at least moderately sensitive to the wishes of citizens. Finally, when political power and wealth are so closely linked, and when politicians can distribute resource revenue however they wish, there is a strong trend to increase the number of government jobs beyond an optimal level.

In many poor countries, the path to wealth almost invariably leads through political office. This is particularly true in resource-rich states in which the government controls access to the revenue generated by resource extraction. When this is the case, those in power have an incentive to maintain tight control over access to resources, and incumbency can emerge as a substantial advantage. Broadly speaking, the evidence supports this intuition. For example, other things equal, states that derive a substantial portion of their revenue from oil wealth tend to have regimes that are longer-lived and less democratic than would otherwise be expected.

It is, of course, difficult to determine exactly why this is so. Consider the example of Nigeria. There, the state-owned oil company is a partner in every project relating to the country’s abundant oil and natural gas, which ensures that government ministers have a constant source of revenue. Such an ownership structure is perfectly rational from the perspective of a politician concerned with staying in power, but it can undermine political accountability for two primary reasons. First, only incumbent politicians (and their allies) have access to resource rents. This means that the advantages of incumbency—present in virtually every democracy—are multiplied significantly, which gives incumbents a strong incentive to stay in power. Second, potential challengers to incumbents see the same landscape as do incumbents. This could have the effect of driving honest leaders from politics or attracting leaders whose only interest is money.

Another explanation for the negative political effects of resource wealth again begins with the assumption that in states rich with resources, those in power will spend prodigiously to remain in power. If this is true, do resource-rich governments spend resource wealth to purchase stability, and if so, what are the effects of this spending? In Africa, states “with large natural resource


138. See, e.g., id. at 17580 (reporting that the national oil company had failed to account for approximately $5.18 billion in revenue).
endowments have higher levels of government consumption than resource-poor countries.”139 Governments can spend this wealth in several ways. One way for incumbent politicians to maintain support is to increase the number of public-sector jobs. This strategy, while useful to those who receive the new jobs and the politicians who may be more likely to be reelected, comes at the cost of “transferring labor from the relatively high productivity private sector to the low productivity public sector.”140 Another strategy is to put in place economic policies to win favor with consumers, by ensuring low prices for consumer goods, and loyal producers, by ensuring low prices for inputs.

Zambia’s experience with resource wealth, albeit extreme, is a useful illustration of both problems.141 To maintain its hold on power, Zambia’s ruling party hired thousands of urban workers to fill government and party positions.142 The government also instituted price controls to benefit urban voters,143 and manipulated financing and licensing requirements to benefit loyal businesses.144 The government paid for these policies using revenue from the state-controlled mining company.145

B. Management Effects

States that receive a substantial portion of their income from selling natural resources (or from any other single source) must act as managers for those resources. The need for political actors to be reliable stewards of wealth is not, of course, unique to resource-dependent states. Unconditioned wealth, however, presents particularly difficult management challenges and creates incentives that can lead even the best managers to make bad decisions. In this section, I assess the incentives that confront states in their roles as managers of wealth. It is important to note that although this part considers some of the economic effects

139. Jensen & Wantchekon, supra note 136, at 828.
141. My discussion of Zambia draws on the thorough analysis in Robert H. Bates and Paul Collier’s The Politics and Economics of Policy Reform in Zambia, 4 J. AFR. ECON. 115 (1995). Bates and Collier analyzed the process of policy reform in Zambia against the backdrop of a history of resource wealth, mainly from copper. They summarized their findings as follows: “The incentives created by the system of Presidential elections induced a systemic bias in favour of the formation of state industries, the conferral of consumer subsidies, and the control of prices.” Id. at 141.
142. Id. at 117 (noting that the ruling party “filled over 40,000 local offices” in the capital alone).
143. Id. at 123-24 (describing policy of the ruling party to implement price controls in urban markets).
144. Id. at 124 (to win the support of loyal firms, the government provided them with “abundant allotments of foreign exchange, priority in the licensing of imports, and sufficient amounts of capital”).
145. Id. (noting that the primary source of finance for the government was the state holding company that included mining, energy, transport, and banking interests).
of resource wealth, it is not an analysis of the economic theories underlying the resource curse. Instead, my goal is to focus on politicians as managers of unconditioned wealth to consider the complicated ways that political and economic incentives combine to produce negative social outcomes.

Politicians as managers face three related challenges. In all instances, two assumptions hold: first, that resources are managed (directly or indirectly) by politicians whose hold on power is unsure; and second, that resource wealth represents their sole or principal reliable source of wealth. Under these conditions, politician managers face a powerful incentive to exploit the resources much more quickly than would otherwise be optimal. If an incumbent politician knows that his political survival depends on his ability to create and fill public sector jobs, for example, his immediate need for revenue may well outweigh arguments supporting a slower extraction schedule. Second, politicians may make poor investment decisions with the wealth generated by resource income. For example, a politician may decide to build a soccer stadium instead of investing in schools.\textsuperscript{146} Or a politician may build a factory at a location that will bring political benefits but is not economically optimal.\textsuperscript{147} Finally, politician managers have an incentive to avoid developing other sources of revenue that may be more sustainable over the long term but are politically unpopular. Low taxes, or poor tax collection, are prominent examples of this.

The experience of Equatorial Guinea illustrates the point. Before 1990, the country was desperately poor; its only real export was cocoa, and prices had fallen dramatically in the previous decade.\textsuperscript{148} But after the discovery of oil and natural gas, the economy grew at an annual rate of more than 41% for five years in a row.\textsuperscript{149} The problem for Equatorial Guinea is that its only real source of wealth is petroleum products. If today's politicians pump oil out of the ground as quickly as they can and use the revenue in unproductive ways, then there is a risk that the country will quickly fall into poverty once again. For many states that rely on resources as a primary source of income, allocating resources

\textsuperscript{146} See Elsa V. Artadi & Xavier Sala-i-Martin, \textit{The Economic Tragedy of the XXth Century: Growth in Africa}, (NBER Working Paper Series No. 9865, July 2003). Artadi & Sala-i-Martin survey data showing that the ratio of public to private investment in Africa has contributed to Africa's poor growth record. Their work, and the research they cite, shows that investment by governments is often inefficient, and not a major contributor to economic growth, because investment decisions are driven by political concerns. Private sector investment—what they describe as "rate-of-return-driven investment"—is more likely to contribute to economic growth because those making the investments are less susceptible to political influences. \textit{See id.}

\textsuperscript{147} See, e.g., James A. Robinson & Ragnar Torvik, \textit{White Elephants}, 89 J. PUB. ECON. 197, 198 (2005) (describing decisions by the government of Zambia to place manufacturing plants in locations that would ensure support from voters even though the locations were not served by reliable transportation networks and alternative locations were available).

\textsuperscript{148} See Jedrzej George Frynas, \textit{The Oil Boom in Equatorial Guinea}, 103 AFR. AFF. 527, 528 (2004) (describing the collapse of the cocoa-based economy).

\textsuperscript{149} See \textit{id}. at 527 (reporting that the gross domestic product of Equatorial Guinea "is said to have grown by a staggering average of 41.6 percent per year between 1997 and 2001, the highest in the world").
between current and future generations is a principal concern. Determining the optimal pace of resource extraction is difficult for any manager, but it is doubly difficult for managers who may lose their grip on power at any time. Another concern is that politician-managers may select resource extraction methods that provide generous revenues in the short term but generate significant long-term environmental problems. Put another way, because politicians in unstable states have high discount rates, they may make decisions that generate negative externalities over the long term.

V. MITIGATING THE EFFECTS OF UNCONDITIONED WEALTH

Given the many problems associated with unconditioned wealth, it should come as no surprise that there is no single prescription that will eliminate all the problems. In this Part, I advance two sets of proposals. The first series of proposals suggest changes in the law that might enhance the ability of market participants to influence the behavior of states, such as China, that invest in poor countries. The second series of proposals are aimed at government officials and state actors that receive investments from abroad. These proposals draw on insights from behavioral economics to show how changes in the law might change how citizens understand and respond to foreign aid or investment.

A. Addressing Governance Problems by Harnessing Market Discipline

One of the conditions on most investments is what is generally referred to as market discipline. At its most basic, market discipline refers to the various mechanisms available to owners of capital to exert influence over the people who manage that capital. It describes the tools available to “providers of capital” to “induce managers to watch over their investments with sufficient anxious vigilance.” It is the relative absence of this constraint that characterizes many of the most troublesome sources of wealth, including Chinese investments in Africa. For example, most resource development projects in Africa are joint ventures involving the host country government and one or more foreign corporations. In Nigeria, for example, the government

150. See generally John Rowse, Using the Wrong Discount Rate to Allocate an Exhaustible Resource, 72 AM. J. AGRIC. ECON. 121 (1990) (modeling the effect on social welfare of using a sub-optimal discount rate to extract a resource).

151. See, e.g., Kostas Tsatsaronis, Comments on the Theory of Market Discipline, in MARKET DISCIPLINE ACROSS COUNTRIES AND INDUSTRIES 79, 79 (Claudio Borio, et al. eds., 2004) (arguing that market discipline “can be viewed generally as the influence that ‘outsiders’ (that is, stakeholders with no executive decision-making power) exert on ‘insiders’ (that is, the decision-makers in an economic unit) that encourages value-enhancing behavior by the latter”).

typically owns 60% of the venture and the foreign corporation owns 40%. In theory, the partners share responsibility for funding the project. In practice, the government rarely produces its share of capital and the foreign corporation raises the funds necessary for the project. In recent years, the Nigerian government has begun to rely on production-sharing contracts, under which the foreign corporation bears all of the costs of developing a project. If the project is successful—if oil is actually discovered and sold—the corporation then recoups its costs and begins to pay royalties to the host government. What is missing is an incentive for the government to be a careful steward of its assets. Just as with a production-sharing contract, in a joint venture in which the government does not contribute its share, the foreign corporation bears all the risk. If the investment is unwise, the government may forego profits, but it does not suffer any real loss because it has not tied up any capital in the project.

Market discipline, as with other forces that influence the decisions of the people and institutions that manage resources, is not a panacea for all the problems that might occur. But it can, under the appropriate circumstances, help to reduce politician/managers’ incentive to use wealth in the most pernicious ways. Conventional accounts of market discipline assume that it will be most effective under free market conditions. That is, investors constantly seek and evaluate information about their investments and decide whether to buy, sell, or lend based on this information, and managers receive and respond to these signals. Market discipline may have a similar constraining effect when it is state behavior, not firm behavior, that is at issue.

Conventional accounts of market discipline suggest that two conditions must be present for the markets to have a positive effect on the behavior of managers. One principal requirement is information: those who would hold accountable the managers of their resources must know what those managers are doing and why. The kind of information required depends on the kind of

153. See Matthew Green & Dino Mahtani, Abjua Eyes Banks for Oil Deal Funds, FIN. TIMES, Nov. 8, 2007, at 5.
154. Id.
156. Id.
157. See, e.g., Robert R. Bliss & Mark J. Flannery, Market Discipline in the Governance of U.S. Bank Holding Companies: Monitoring vs. Influencing, 6 EUR. FIN. REV. 361, 361-62 (2002) (arguing that the “market discipline paradigm requires (a) that the necessary information is publicly available and that the private benefits to monitoring outweigh the costs, (b) that rational investors continually gather and process information about traded firms whose securities they hold and about the markets in which they operate, (c) that investors’ assessments of firm condition and future prospects are impounded into the firm’s equity and debt prices, and (d) that managers operate in the security holders’ interests. The prices of a firm’s traded securities are the most obvious public signal by which the stakeholder/monitors make their evaluations known to management”).
158. See, e.g., Erlend Nier & Ursel Baumann, Market Discipline, Disclosure and Moral Hazard in Banking, 15 J. FIN. INTERMEDIATION 332, 333-34 (2006) (arguing, in the context of assessing the
wealth, the industry, and other factors. But what matters is that owners have the information they need to determine whether managers are acting in a way that is consistent with the owners’ goals. A second essential condition for effective market discipline is the availability of mechanisms by which owners of capital can influence the decisions of managers. One obvious tool is for shareholders to sell their stock in response to an apparently bad strategy implemented by a firm’s management. If enough owners do so, managers receive a strong signal that shareholders view their strategy negatively and, consequently, should change their behavior. Implicit in this argument is that owners have an incentive to exert influence. For example, if owners know that managers’ poor decisions will not negatively affect owners—because of, for example, a government program that insures investments—then owners lack a strong incentive to discipline managers (or even seek the information necessary to do so).

1. Shares in State Investment Projects

Recall that I rely on the concept of market discipline to suggest ways to influence the behavior of states. The market discipline approach might improve the behavior of states due to the overlap between the conditions necessary for a congenial business environment and improvements in social welfare; directly, it could improve state behavior through pressure by private firms on states. State competition for capital can lead to improvements in social welfare by creating an incentive for the government to combat corruption, reduce unproductive, politically-motivated spending, and develop the infrastructure that benefits investors and citizens alike. The slow pace of development in Africa is often attributed to a paucity of investment in the continent. This assumption underlies much of the conventional model of aid, which calls for significant increases in the flow of aid from the West to the developing world. While there is surely merit to the general notion that more investment would contribute to more development (setting aside the issue of what is the optimal form of investment),

banking industry, that investors must “have adequate information to gauge the riskiness of the decisions made by managers of their capital).

159. See, e.g., Bliss & Flannery, supra note 157, at 363 (arguing that a necessary component of market discipline is information to permit investors to “accurately understand changes in a firm’s condition”).

160. Id. 393 (arguing that market discipline requires that owners have the tools to “influence managerial actions in appropriate ways”).

161. Id. at 363 (arguing that changes in the price of securities are a primary mechanism by which managers receive information from owners).

162. Nier & Baumann, supra note 158, at 332, 334.

163. See, e.g., Hongbin Cai & Daniel Treisman, Does Competition for Capital Discipline Governments? Decentralization, Globalization, and Public Policy, 95 AM. ECON. REV. 817, 825 (2005) (arguing, based on empirical examination of Russia’s transition economy, that more “business-friendly policies and institutions were associated with higher inflows of investment”).

164. See generally SACHS, supra note 2; OUR COMMON INTEREST, supra note 2.
this notion does not explain why past investment has done so little to improve economic and social conditions in most of these countries.165

Part of the explanation is that public investments directed by incumbent politicians tend to be less productive than private investments.166 For example, in Burundi, the “evidence shows that the location of public projects is determined by the desire of politicians to redistribute to their own geographically based groups.”167 Another notorious example comes from Nigeria, where the Ajakouta steel plant has received millions in government investment yet has not produced any saleable steel in 40 years.168 Politicians have an incentive to champion such projects, even when the projects lose money, because they demonstrate a politician’s ability to channel resources to his allies.169 This problem is exacerbated when states such as China provide financing for projects that are directed by politicians. Seen in this light, when China provides a line of credit to the government of Nigeria in exchange for the right to develop an oil block, or it agrees to provide financing for a railway in Angola, these investments look more like political slush funds than arms-length investments designed to generate a financial return.

For many states in Africa, political and market forces simply do not have a real effect on their investment decisions. If politicians invest inefficiently, some of their constituents may applaud if the investment rewards a favored group. Perhaps more often, their constituents may have no way to give voice to their displeasure. One possible mechanism for addressing this problem might be to broaden the kinds of investment vehicles available to governments and create marketable securities in them. Most sovereign investment funds operate as vehicles through which states invest foreign exchange surpluses. But they could be expanded to include, for example, the state’s investments in joint-venture oil deals, or the state’s investments in domestic infrastructure projects. This would not necessarily mean that outside investors would be involved in sovereign investment decisions, or that states would ignore strategic issues when investing or accepting investments. But it could subject state investments to at least some market discipline by creating a financial penalty for pursuing inefficient projects.

165. See generally EASTERY, supra note 3.
166. See Artadi & Sala-i-Martin, supra note 146, at 8.
169. See Robinson & Torvik, supra note 147, at 209 (arguing that politicians who seek the loyalty of a geographically-bound constituency may favor loss-making projects because of their effect on voting behavior).
2. Creditors Control Rights

When Chinese firms compete for investment opportunities in Africa, they often have an advantage that other firms do not. The Chinese government, like the United States and other wealthy governments, provides subsidized loans to governments in the developing world. China does this through the China Export-Import Bank, which loans money to foreign buyers who wish to purchase Chinese goods, and provides financing for Chinese firms' overseas investments. These loans are at below-market rates. An effect of this support is to make it possible for Chinese firms to win access to infrastructure projects that would otherwise not be economically justifiable because of the poor anticipated rate of return or the expense of insuring such a risky investment. The benefit for China is that its support for African leaders' infrastructure projects helps it gain access to resources—mainly oil—that the Chinese economy needs. For example, when Nigeria conducted its most recent auction of oil block concessions, China's national oil company won a block by promising a $2.5 billion loan package to the Nigerian government.

Although appealing to African politicians for the reasons discussed above, this kind of deal can have negative effects on a country's political system, economic health, and social welfare. First, because the loans are free of conditions (except that they be repaid), the packages provide incumbent Nigerian politicians substantial sums with which to consolidate power. Second, these packages can influence the kinds of domestic investments that occur, with politically expedient investments winning out over projects that are more efficient.

Another response to these problems appears to be near a real-world test. As described above, most project finance agreements create joint ventures involving the state and foreign corporations. Historically, one problem has been that states do not contribute their share of the capital necessary to fund the project. A response has been to force the partner corporation to raise more money on its own. But a new form of financing appears to be under consideration. Instead of relying on the state to contribute money, the joint


171. Id. ("The interest rate that Chexim charges for these [loans] can be 3 percent lower than commercial rates.").


173. See Chan-Fishel & Lawson, supra note 170, at 65 (describing Nigeria's 2007 oil auctions). See also id. at 65-66 (noting similar deals were struck in Angola, Uganda, and Zimbabwe).
venture would raise money in capital markets. This might, in theory, force states to reveal more information about the project, including potential conflicts with local populations, potential environment liabilities, and the like. Taken together, the provision of this information and the inclusion of market investors might permit citizens and investors alike to exert more influence on the behavior of firms and the state agents who manage Nigeria’s vast oil wealth.

**B. Mitigating the Effects of Unconditioned Wealth Through Distribution, Taxation, and Mental Accounting**

In this Part, I suggest possible ways to mitigate the harms of unconditioned wealth by harnessing some of the behavioral biases associated with wealth. When individuals receive income, their willingness to spend it depends in large part on the mental account to which they assign it. Salary is segregated from money found in the street, for example, and individuals are willing to spend found money on items that they would never consider purchasing with their salaries. One hypothesis for the apparent tendency of politicians in some resource-rich countries to abuse resource rents might be that they assign this revenue to the wrong mental account. Put another way, if politicians view unconditioned wealth as found money rather than salary, it may be easier for them to abuse it.

The way individuals treat wealth is enormously complex, but there is compelling evidence that most people behave in a way that conflicts with one of the central assumptions of economics: the fungibility of wealth. Instead of indifference regarding the source of wealth, most people use a system of “mental accounting” when they receive income. They assign wealth to different “mental accounts” depending on the source of the wealth, or its intended purpose, or some other factor. The temptation to spend from these different accounts is different. People feel less tempted to spend money they have assigned to a mental savings account than they do to spend money they have tagged as income, for example. Consider the results of one large econometric test of the life-cycle hypothesis. It used a dataset that included information on the earnings, savings, and consumption decisions of 11,000 households over a period of 11 years. The study evaluated the effect of five different assets on

174. See Green & Mahtani, supra note 153, at 5.


176. See Richard H. Thaler, *Psychology and Savings Policies*, 84 AM. ECON. REV. 186, 188 (1994) (noting that the empirical evidence shows that “an extra dollar of housing wealth, pension wealth, or current lottery winnings” do not “generate the same increase in consumption”).


178. Id. at 66 (database derived from the Longitudinal Retirement History Study, which gathered data every two years from 1969-1979).
consumption decisions. Although the study reached a number of conclusions inconsistent with the life-cycle hypothesis, particularly salient for my purposes is the finding that increases in current income produce greater increases in consumption than do increases in most other forms of wealth. It found that "a $1 increase in income has as much effect on consumption as a $26 increase in wealth." If consumers actually treated each dollar as fungible—that is, they were equally willing to spend wealth and income—these results would imply that the consumers assumed an interest rate of negative 2.3 percent.

To this point, I have considered generally the ways that individuals frame different sorts of wealth by coding "various components of wealth into different mental accounts, some of which are more ‘tempting’ to invade than others." Of particular interest to me is one kind of mental account, which I refer to as "unconditioned wealth." Unconditioned wealth is like money found in the street—uneearned, unexpected, and valuable. The difficult question is to determine just how valuable it is. Suppose that a person finds a dollar in the street. Would she spend that dollar as quickly as she would a dollar of her salary? We know from the mental accounting literature that the likely answer to this question is that she would place a lower subjective value on a dollar of windfall wealth than she would on a dollar of salary. The empirical literature supports this hypothesis. Consider the results of one experimental test. Researchers sought to determine whether the "subjective value of windfall dollars would be less than the subjective value of non-windfall dollars." In one part of the experiment, subjects were divided into two groups. Members of one group were asked to assume that they had won $105 in a radio contest. Members of the second group were asked to assume that they had worked overtime and earned $105 over and above their usual wages. Members of each group were then asked about the likelihood that they would spend the money on a television or save the money. The clear result was that the dollars won in a radio contest—the "windfall gains"—were "spent more readily than

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179. Id. at 68 (The study included "current income, liquid assets, value of house, future assets and non-liquid assets.").

180. Id. at 82 (noting that the study produced "four major results" that are inconsistent with the assumptions of the life-cycle hypothesis).

181. The study compared the effect of "receiving an extra dollar of permanent income" to the effect of "receiving an extra amount of wealth equal to the present value of that dollar." Id. at 77.

182. Id.

183. Id.

184. Shefrin & Thaler, supra note 175.


186. Id. at 335.

187. Id.
earned money."\textsuperscript{188}

What can explain this difference? Why do people appear to be less willing to part with a dollar earned from work than a dollar won in a contest? There are at least two plausible hypotheses that might account for this result. First, it may be that individuals place more value on dollars that are earned than those that are won. Put another way, perhaps the exertion of effort to earn a salary causes individuals to place more value on those dollars relative to dollars acquired with less effort. A second possible explanation is that individuals form a wealth baseline, which includes consideration of future earnings. Wealth incorporated into this baseline might be allocated to different needs (or desires), and spent accordingly. On this account, so long as the individual’s actual wealth is consistent with her expectations, her spending patterns will hold. But if she unexpectedly comes into more money, she will be more likely to spend that money on items that would not ordinarily prompt her to open her wallet.

The earned versus unearned hypothesis does not appear to hold up well in tests. In one experiment, college students were first asked to rate several hypothetical summer jobs—ranging from pouring hot tar on a road construction crew to working in a shoe store—according to the difficulty of the job.\textsuperscript{189} A second group was then divided in two, with one asked to assume they had earned money working as a lifeguard and one asked to assume they had earned money pouring hot tar in a construction crew.\textsuperscript{190} When asked about their likely spending decisions, “subjects’ willingness to spend” was not affected by the difficulty of the job.\textsuperscript{191} Though far from conclusive, this experiment suggests that “the earnedness of funds” is not the “determining factor in the tendency to spend money.”\textsuperscript{192} It might still be true that “earnedness,” when combined with other factors, contributes in some way to willingness to spend, but this is not clear.

The second hypothesis—that individuals are more willing to spend wealth that is considered a departure from the baseline—holds up better in tests. Researchers from Harvard and the University of Chicago designed an experiment to assess whether individuals were more willing to spend a tax rebate if it was described as “returned income” or “additional income.”\textsuperscript{193} Participants “in the bonus condition recalled spending dramatically more of their rebate check than participants in the rebate condition.”\textsuperscript{194} In a separate

\textsuperscript{188} Id. at 336.
\textsuperscript{189} Id. at 337. Participants were asked to consider four summer jobs: server at a restaurant, lifeguard at a beach, construction laborer pouring hot tar, and salesperson at a shoe store. \textit{Id.}
\textsuperscript{190} Id. at 338.
\textsuperscript{191} Id.
\textsuperscript{192} Id.
\textsuperscript{193} Nicholas Epley, Dennis Mak & Lorraine Chen Idson, \textit{Bonus or Rebate? The Impact of Income Framing on Spending and Saving}, 19 J. BEHAVIORAL DECISION MAKING 213, 216 (2006).
\textsuperscript{194} Id. To account for the possibility—however low—that there might be a non-random distribution of memory errors regarding how participants had actually spent their money, the
experiment, the same researchers told undergraduates that they would receive either a "bonus" or a "rebate" of $25, which they could spend at the university bookstore. Any items they purchased at the bookstore would be discounted 20%, and unspent money would be given to participants as a check. Again, participants in the bonus group spent much more of their income than those in the rebate group. In addition, the researchers tested two possible psychological explanations for the results; neither explanation proved likely. First, researchers determined that the differential spending patterns were not likely caused by an "asymmetrical gain/loss weighting function." In other words, subjects' willingness to spend did not seem to turn on whether they considered the money to be a "returned loss" or "an additional gain." Although conventional prospect theory suggests that this distinction might be salient in some situations, it did not influence the results in this experiment. Moreover, subjects' willingness to spend did not seem to influence their perceptions of their previous spending behavior. It "is possible that returning money . . . in the form of a rebate highlighted past expenditures that a bonus does not." Once again, this possible explanation did not appear to drive the results.

Thus, there is little support for the "earnedness" hypothesis, but there is support for the bonus versus rebate hypothesis. To be sure, none of this evidence is exhaustive, and other possible explanations may be at work. But there is some support for the idea that, for individuals at least, wealth that is viewed as a bonus, over and above the amount mentally slotted to satisfy needs, is more readily spent than wealth that is viewed as restoration of the baseline.

Before moving on, it is important to acknowledge a potential weakness in my argument. To this point, my analysis has focused on the ways that individuals account for financial windfalls and other infusions of wealth. The most compelling explanations for hard-to-understand individual behavior all come from psychology. Individual patterns of spending and savings appear to be driven in large measure by the feelings people derive from or associate with spending money from one source versus money from another source. These feelings lead people to make what appear to be, to many economists, systematic errors, such as assigning greater value to one dollar than to another depending

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195. Id. at 221.
196. Id.
197. Id.
198. Id. at 223.
199. Id.
201. Epley, Mak & Idson, supra note 193, at 223.
on the source of the money. At this level of analysis, psychological explanations are perfectly appropriate because the goal is to explain individual behavior. But can we apply psychology to state-level behavior? The narrow answer to the question is clearly no: explanations for behavior based on feelings or emotions or the like are a poor fit when analyzing state-level behavior. My goals are broader, making a broader range of evidence relevant. My aim is to specify the ways that individuals and institutions respond to the incentives that appear to exist in the real world. For individuals, psychological explanations are obviously important. Such explanations have been made even more important by the absence of explicit recognition of the psychologically complex ways that individuals weigh different potential risks and rewards. For strict rational choice scholars, psychology is present only indirectly: individuals are thought to derive satisfaction only from increases in wealth. Prospect theory is but one of a host of explanatory models showing that the traditional, rigid model is inapposite. Instead, it is important to identify the many incentives facing individual decision makers—including wealth maximization but not limited to it—to arrive at a more nuanced explanation of human behavior.

The use of explanations derived from individual psychology to explain the behavior of states or regimes presents a greater challenge. One response to this problem is that, because individuals govern states, evidence of the ways that individuals make decisions is relevant. And, to the extent that my analysis is limited to regimes in the developing world, this response is largely sufficient. When power is concentrated in the hands of a small number of individuals, individual psychology is important. This is especially true when the type of power at issue is the authority to decide who has access to rents from resources and how those rents are distributed.202 A second response to the unit-of-analysis objection is more general. If we assume that state behavior represents the distillation of the preferences of many constituencies, and that behavioral or decisional biases are common, then the actions of states may well reflect those biases. Thus, even if state behavior is guided by institutions, not individuals, state behavior may still be influenced by individual biases.203

1. Distribute and Tax Resource Revenue

One way to create an appropriate frame for revenue from resource rents or foreign investment would be to distribute the revenue to individuals and then tax

202. See generally Jack S. Levy, Prospect Theory, Rational Choice, and International Relations, 41 INT'L STUD. Q. 87 (1997) (analyzing the application of theories of cognitive biases to state activity when those activities are dominated by individual leaders).

203. See generally J.M. Goldgeier & P.E. Tetlock, Psychology and International Relations Theory, 2001 ANN. REV. POL. SCI. 67 (2001) (showing the potential influence of findings from cognitive social psychology and behavioral psychology on various theories of international relations).
it, thereby forcing politicians to account for funds in a much fuller way. This is, of course, a version of the mechanism that Alaska uses to distribute revenue from oil. In Alaska, oil dividends are paid to all residents. Although this income is not taxable, it does serve as an accountability mechanism by giving all citizens an interest in the outcome of oil development deals. Taxing the accounts would be a way to harness a version of the endowment effect. When resource or investment revenue flows to politicians, citizens never really take ownership of it. When politicians distribute wealth to citizens in the form of public sector jobs, for example, politicians can claim credit for beneficence, rather than face questions about why the wealth was not more efficiently used. If citizens were to take ownership of resource or investment wealth, they would view a reduction in revenue skeptically.

2. Eliminate Signature Bonuses

Many politicians in developing countries receive sizeable “signature bonuses” for approving resource or other investment deals. The most plausible defense of a signature bonus (in the context of developing country investments, at least) is that it can serve as an immediate payment to a poor government that may not otherwise see any benefits from the deal for many years. But the potential for abuse is clear. Perhaps most obvious, signature bonuses may be little more than bribes designed to reward a cooperative politician. In addition, signature bonuses compete with other forms of payment—namely, royalties to be received as the project earns money. When a politician “with a short time horizon in anticipation of an eventual ouster wants the cash right away,” he has a strong incentive to negotiate a large signature bonus and a lower royalty rate. Finally, to a politician, a signature bonus may well look like the kind of income that should be assigned to the wrong mental account. A payment over and above his ordinary income, often not publicly disclosed—a signature bonus looks much more like found money than salary.


205. Id. at 1159-60 (describing possible mental accounting effects of natural wealth accounts).

206. For a contrary view, see Shaxson, supra note 115, at 1135-38 (arguing that the distribute-then-tax model would be inefficient).


208. Id.
VI.
CONCLUSION

What can be done to reduce the harmful effects of unconditioned wealth? As discussed above, the objective of most foreign aid is to improve social welfare in the targeted countries. How best to do this generates considerable debate—about what should be done, who should be involved in implementing the plan, and even what the goal should be. But what they all promise, and what we are beginning to see, are increases in the amount and changes in the type of resources flowing into Africa.

Recognizing the effects of unconditioned wealth on the behavior of states should give some pause to all participants in the debates over optimal development policy. Those who argue that more aid is the key to improving the lives and prospects of people in poor countries would do well to consider the incentives created by even well-intentioned aid provided without the right mix of conditions. Given the political conditions in many recipient states, there is reason to worry about how these governments will use the aid. On the other hand, those who argue that development will best occur via market forces should recognize the many ways that political factors affect market forces and that market forces are most effective only under particular conditions. In the end, it may turn out that what matters most are the conditions attached to wealth, not the source of wealth.