

The Resource Curse and Corporate Transparency

Companies respond to government predation with lower corporate transparency

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High oil prices have rekindled interest in the negative effect of resource abundance on economic growth. Known as the "resource curse", it has recently been linked to the deterioration of economic and political institutions. In particular, economists have hypothesized that if resources are discovered in an economy with immature institutions, the resulting rent-seeking slows down or even reverses institutional development, which in turn, negatively affects growth. In contrast, countries with mature institutions (such as Norway or Australia) may benefit from their resource wealth and channel newly discovered resources to the development of other sectors.

Testing this hypothesis empirically is not easy. As most institutions change slowly, one has to rely on cross-sectional evidence which is vulnerable to reverse causality and omitted variable bias. In order to understand the mechanisms of the resource curse we need to use micro-economic data. In our recent research we have studied the effect of resource abundance on growth through its effect on corporate transparency and property rights, using data on 72 industries in 51 countries over the period 1990-2005.

We argue that during periods of high commodity prices, corporate profits in the natural resource industries represent rents that are relatively easy for governments to capture. Firms in such industries face a trade-off. On the one hand, to attract external capital, they desire transparency. On the other hand, higher transparency involves a risk of expropriation by the government or rival companies. Various forms of government expropriation include the extortion of bribes, overregulation, disregard for property rights, confiscatory taxation, and the outright seizure of firm assets. Transparency would therefore be lower in industries that are more vulnerable to expropriation, particularly in countries that have poor protection of property rights.

Timeless Relevance — Regrettably

The argument is not new. In the "Wealth of Nations", Adam Smith wrote: "In those unfortunate countries, indeed, where men are continually afraid of the violence of their superiors, they frequently bury and conceal a great part of their [capital] stock".

The quintessential example is the story of Yukos, once Russia's largest and most transparent oil company, and its founder Mikhail Khodorkovsky. Khodorkovsky and his partners acquired a stake in a notorious loans-for-shares auction and then diluted the stakes of other shareholders, including foreign investors and the government. Once they assumed control over the majority of voting and cash flow rights, the firm's transparency and corporate governance improved substantially. Khodorkovsky was the first of the Russian oligarchs to disclose his personal stake in a major company and to invite reputable foreigners to join the corporate board. This raised Yukos market capitalization fifteen-fold in less than four years but also eventually resulted in the full expropriation of the company by the government and imprisonment and exile of the key owners and managers. While the official charges against Khodorkovsky were related to tax fraud, there is a widespread belief that the government's assault was driven by a combination of Khodorkovsky's political ambitions and the firm's openness about its high value.

The Yukos affair was certainly not an isolated case and its relevance goes well beyond Russia, extending to *Expropiacion Petrolera* in Mexico in 1935 and recent nationalizations in Venezuela, Bolivia, and Ecuador.

Negative Effect on Growth

In testing the within-country variation in firm transparency levels induced by government rent-seeking we construct several indices, including the opacity index, which reflects the degree of manip-

ulation and withholding of information, and the predation index, which encompasses information on countries' rule of law, risk of government expropriation, corruption, quality of bureaucracy, regulation of competition, etc. We find that:

- Companies around the world respond to government predation with lower corporate transparency. This is especially true for oil and gas industries, and more so when the price of oil is high and property rights are poorly protected;
- Opacity increases when a government is more autocratic or when it favors redistributive policies, i.e. has a left-leaning political orientation. The opacity also increases during election years reflecting the increased uncertainty about future government policies;
- Lower transparency in oil price-sensitive industries results in less efficient capital allocation and eventually lower corporate growth.

The difference in corporate growth between an expropriation-sensitive industry (e.g. oil and gas) and an industry with little expropriation risk (e.g. agriculture) is not trivial in a predatory country. For example, in Venezuela the oil and gas industry would grow slower by 1.8% compared to agriculture. This can be compared to Norway — the country with high-quality institutions, where the differential growth rate between oil and gas extraction and agriculture would only reach 0.1%.

Thus, it turns out that the resource curse is indeed a corporeal phenomenon. It affects — in a very tangible way — corporate transparency in actual firms. This results in material consequences for capital allocation and the growth of these firms.

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