

## **The State Independent from voters: Rent Revenue Incomes and the Resource Curse**

Mau Vladimir  
RANEPA, rector

Ilia Zatscovecky  
Research Fellow

Samuel Neaman Institute for Advanced Studies in Science and Technology

Konstantin Yanovskiy  
Head of Institutional Development Department  
Gaidar Institute for Economic Policy  
Moscow, Russia

See for updates: <http://ssrn.com/abstract=2390348>

*If the authorities have the opportunity to receive incomes uncontrolled by society, this gives them great freedom of action. Such incomes do not depend on the quality of the public goods delivered, nor on the investment climate. Given a certain minimal level of organization, taxpayers can try to impose on the government, which needs their money, their own terms for using the resources received (and history has shown that this can often be done successfully). The history of many modern parliaments began with gatherings convened by the people whose money and armed forces made up the might of the state.*

*The absence of a need for the regime in power to ask its subjects for financial support in return for guarantees and privileges makes the regime's forces, which are far superior in comparison with any individual market agent's capacity, practically uncompensated for in any way. And if the government's incomes enable it to offer bribes to citizens, then the authorities' uncontrollability can weaken or even destroy the democratic institutions already in existence. Under such conditions, there can be no talk of constraints capable of providing universal secure guarantees for business independently of the will of the ruler.*

Key words: Rent revenue, voters' corruption, voters bribe, demand for institutions

JEL codes: D72, D73, P16, O33

English by Elen Rochlin

**T**he subject of rent economy and its connection to the construction of democratic institutions have been studied by many researchers over the last few decades. Yet there is still no one clear answer to the question of whether such a connection actually obtains, or what its cause may be. The present chapter introduces

an economic model of the process of electoral corruption in rentier states; it also traces the connection between the stage of the emergence of state institutions, when the condition of rent dependence first develops – and the nature of these institutions.

## The State of the Problem

“Rent” as a term was first introduced into economic discourse by D. Ricardo, who defined it as referring to “incomes not achieved as a result of productive human activity, but constituting compensation for the rarity of natural resources.”<sup>1</sup>

The definition of rent has undergone significant change since Ricardo’s day. Today the term is usually applied in economic theory to incomes having the following three features:

They come from abroad;

They come directly to agencies of the state;

A very modest percentage of the citizens are employed in obtaining the incomes, with the overwhelming majority only enjoying what these incomes yield.<sup>2</sup>

Other types of income featuring different qualities but occasionally also referred to as rent revenue, are not here being considered.

A rentier state is a state regularly receiving sizable rent revenue payments.<sup>3</sup> This definition was first provided by Hossein Mahdavy in his 1970 paper with reference to Iran during the reign of Reza Shah Pahlavi.<sup>4</sup> The term “rent economy” is more familiar in writings published in the Russian language; this is the term we will continue henceforth to use.

This was usually the definition used by writers analyzing the policies of those countries whose economies were based on exporting natural resources, especially petroleum (as a rule, states of the Middle East).<sup>5</sup>

The attitude to rent revenue payments as a factor impacting the economic development of the state has undergone considerable change since the beginning of the term’s existence. Ricardo saw rent (i.e., natural resources) as a powerful positive factor. Yet during the last few decades, a number of studies have been published demonstrating the stable negative dependence relationship between a wealth of natural resources and the social-economic development of the country.<sup>6</sup>

Researchers cite a number of different reasons for this thoroughly paradoxical outcome.<sup>7</sup> In cases when the rent revenue payments depend on natural resources exports, a strong impetus obtains for the development of single-product exports. This leads to a slowdown in the other branches of the economy: an influx of cheap foreign

---

<sup>1</sup> D. Ricardo, *On the Principles of Political Economy and Taxation* (L.: John Murray, 1921), pp. 54-55.

<sup>2</sup> H. Beblawi, “The Rentier State in the Arab world,” in Giacomo Luciani, ed., *The Arab State* (Berkeley: University of California Press, 1990), pp. 87-88.

<sup>3</sup> H. Mahdavy, “The Pattern and Problems of Economic Development in Rentier States: The Case of Iran,” in *Studies in the Economic History of the Middle East*, M.A. Cook, ed. (Oxford: Oxford University Press, 1970), p. 428; D.L. Diamond, J.J. Linz, and S.M. Lipset, eds., *Democracy in Developing Countries* (Boulder, CO: Lynne Rienner, 1988); R. Inglehart, *Modernization and Postmodernization* (Princeton: Princeton University Press, 1997).

<sup>4</sup> Reza Pahlavi was the Shah of Iran from December 15, 1925, until September 16, 1941.

<sup>5</sup> G. O’Donnell, P.C. Schmitter, L. Whitehead, eds., *Transitions from Authoritarian Rule: Prospects for Democracy* (Baltimore: Johns Hopkins University, 1986).

<sup>6</sup> T. Karl, *The Paradoxes of Plenty: Oil Boom and Petro-States* (Berkeley, CA: University of California Press, 1977); J. Sachs and A. Warner, “Natural Resource Abundance and Economic Growth,” in *NBER Working Paper Series*, N 5398 (Cambridge, MA: 1998).

<sup>7</sup> See V. Mau, 2012.

currency stimulates imports of most goods and undermines the status of the producers at home.

Thus, a time comes when the country becomes totally dependent on oscillating prices for a thoroughly limited set of goods which it exports.

Besides, raw material branches of the economy present lower-level requirements for a skilled labor force. This means that their dominance in the country's economy brings down the demand for education services, a circumstance which may portend thoroughly long-term consequences.<sup>8</sup>

A further danger surfaces when rent revenue incomes pour into the national economy all of a sudden and in enormous quantities; as a rule, this happens in the aftermath of a leap in natural resources prices. If the government treats state natural resources as a generator of stable income, temptation waxes strong to take advantage of new opportunities for ambitious foreign and internal political projects, social programs, and more. Insofar as the income generator seems inexhaustible, the country's leadership willingly takes out loans, aiming to obtain today's political gains based on the surety of future profits. A balanced budget does not appear to be indispensable, either. As a result, a few years down the road, the country, burdened by foreign and internal debt, finds itself embroiled in a great number of political and economic intrigues. Decrease in rent payments during this period spells out catastrophe.

High rent revenue incomes also have an impact on the effectiveness of decision making: on the one hand, the danger is eliminated of penalties for taking risky or unprofessional steps, since wrong steps taken can always be corrected by a monetary influx. On the other hand, the risk of corruption goes up, corruption becoming almost inevitable when it devolves upon the authorities to take on the division of the rent revenue.

Another feature of rent incomes which is of interest to economists is in the impact which rent revenue payments have on the political development of society and the possibility of the emergence in it of democratic institutions. The positive correlation between a democratic system and achieving a certain level of economic development has been extensively studied in the literature. Even so, a brief glance suffices to make it clear that rentier state economies are typically distinguished by more or less authoritarian regimes.

To date, three main theories have been put forth which explain the mechanism of the causal connection between rentier state economies and the absence of democracy. M. Ross classified them in this way: "the rentier effect," "the repressive effect," and "the effect of modernization."<sup>9</sup>

The first theory states that a rentier state stands in no need of taxes. Thus, it need not be accountable to its citizens, and may be perfectly independent of society. It can then rely on the distribution of goods to achieve the same support which a democratic state obtains with the help of a system of taxes and representation.<sup>10</sup>

The second theory, which explains the absence of democracy by the effect of repression, does not contradict the first, but directs attention to another channel for disbursing rent revenue payments: attempts to bribe or destroy the opposition.<sup>11</sup>

---

<sup>8</sup> See T. Gylfason, 2001.

<sup>9</sup> M.L. Ross, "Does Oil Hinder Democracy?" in *World Politics* 53 (April 2001), pp. 327-328.

<sup>10</sup> L. Anderson, "The State in the Middle East and North Africa," *Comparative Politics* 20 (October 1987), p. 10.

<sup>11</sup> Q. Wiktorowicz, "The Limits of Democracy in the Middle East: The Case of Jordan," *The Middle East Journal* 53 (Autumn 1999), p. 608.

Unlike the first two theories, the third one focuses not on the state, but on society. According to this, income derived from rent revenue payments alters the class makeup of society, putting a halt to those trends in it which should have led to the emergence of modern democracy.<sup>12</sup>

But all three theories have one shortcoming in common. Few rentier states had ever been distinguished by the democratic nature of their ruling regimes even before rent revenue payments first began to play a significant role in their economies. A considerable share of these states – which, in effect, provides researchers with the bulk of their material – consists of states of the Middle East marked by a specificity all their own. Trying to circumvent this problem, many researchers simply ignore Middle East data.<sup>13</sup> It thus becomes difficult to assess just what the real reason for the absence of democracy consists in, or whether rent revenue payments have a substantial impact on the process of the emergence of totalitarian institutions.

A group of Russian researchers<sup>14</sup> has suggested a behavior model for dictators, bureaucrats, and citizens vis-à-vis mass media signals in situations of high rent revenue payments. The authors conclude that motivating factors for censoring the mass media are positively correlated with rent revenue incomes (evaluated with a view to the share of the raw materials industry in the GDP). The article includes a brief survey of the literature (including works by such authors as Ross, Acemoglu, and Robinson), and a survey of instances Source the most recent developments in political history, which bear out the point of view of the authors. As has been shown above (see Lisin, Yanovskiy et al, 2011, Chapter 2), the model is vulnerable to criticism. The data relied upon by the authors (especially the “Freedom of Speech” rating) are also far from being beyond reproach. However, the existence of a large number of countries which are rich in resources and where dictatorships prevail, and the absence of instances of the emergence of democracy under conditions of resource plenty evidently bear out the general conclusion arrived at.

Econometric studies based on data from states located in different regions of the world have provided no clear answer to this question. Thus, in the paper cited Ross arrives at the conclusion that petroleum rent payments have a statistically significant stable negative impact on the level of democracy in the state, and that this holds in all regions.<sup>15</sup> K. Tsui supports his conclusions, but notes that rent payment revenue has a different impact on states democratic from the outset and those non-democratic from the beginning.<sup>16</sup>

Tambovtsev and Valitova<sup>17</sup> have shown that being rich in resources has a negative impact on property rights guarantees. A survey of works by other authors who arrive at similar conclusions can be found in the study by Guriev and Sonin.<sup>18</sup>

---

<sup>12</sup> J. Delacroix, “The Distributive State in the World System,” *Studies in Comparative International Development* 15 (Fall 1980), p. 3-21.

<sup>13</sup> G. O’Donnell, Ph.C. Schmitter, L. Whitehead, eds., 1986; D. L. Diamond, J.J. Linz, S.M. Lipset, eds., 1988; Inglehart, 1997; A. Przeworski, F. Limongi, “Modernization: Theories and Facts,” *World Politics* 49 (January 1997); A. Przeworski, M. Alvarez, J.A. Cheibub, F. Limongi, “What Makes Democracies Endure?” *Journal of Democracy* 7 (January 1996); idem., *Democracy and Development: Political Institutions and Well-Being in the World, 1950-1990* (N.Y.: Cambridge University Press, 2000).

<sup>14</sup> Egorov, Guriev, and Sonin 2007.

<sup>15</sup> Ross 2001, p. 356.

<sup>16</sup> K.K. Tsui, “More Oil, Less Democracy? Theory and Evidence from Crude Oil Discoveries,” University of Chicago Job Market Paper of December 29, 2005.

<sup>17</sup> See V. Tambovtsev, L. Valitova, “Resursnaya obespechennost’ strany i yeyo politiko-ekonomicheskoye posledstviya” [“Resource Plenty in a Country and Its Political-Economic Consequences”], *Ekonomicheskaya politika [Economic Policy]* 2007, #3 (7).

By contrast, M. Herb finds no corroboration of such dependence. His study's conclusion: the level of democracy under rentier economic conditions depends on the level of democracy in the region.<sup>19</sup> These findings are to some extent borne out by an earlier study by R. Barro, who indicates Islam as a powerful anti-democracy factor.<sup>20</sup> Even so, as has already been noted above, no definitive answer is to be obtained.

The economic model proposed by us is designed to resolve certain contradictions. According to this model, given a rentier economy, the level of democracy in the state will not rise above that which was in evidence prior to the initial emergence of the rent payments; besides, the democracy level is highly likely to go down. The reasons for this are buried deep in voter corruption, or in the artificial concocting of the situation in which the rational consumer of public goods and civil liberties will opt for the former in preference to the latter. At the same time, the absolute level of democracy depends on how developed state institutions are at the time of the emergence of a condition of rent revenue payment dependence.

Having specified these points, we now go on to a presentation of the economic model of voter corruption, and then consider those states which demonstrate the model in question (Israel, Venezuela, Mexico, Norway, the USSR, and Russia). In closing, we will specify some preliminary conclusions and indicate venues for future studies.

### **Rent Revenue Payment as an Instrument of Voter Corruption: An Economic Model**

Let us make the following assumptions:

In a state with population  $N$ , citizens maximize utility  $u_i$  of every  $i^{\text{th}}$  citizen, which is a positive function of the consumption of public goods  $x$ , the opportunity to impact state policy  $v$ , and a negative function of payment of taxes  $t$  (thus,  $x$  and  $v$  are to some extent mutually replaceable goods).

This ratio can be written as the formula

$$\text{Max } u_i = u_i(\overset{+}{v}_i, \overset{+}{x}_i, \bar{t}_i),$$

$$\text{Max } u_i = u_i(v_i^+, x_i^+, t_i^-),$$

where  $i = 1, 2, \dots, N$ .

State profit at any moment is considered identical to the profit of agents employed by offices of the authorities and of state management.

The state is the monopoly-holding supplier of public goods.

Public goods  $X$  are created using money obtained from taxes  $T$  and rent revenues  $R$ . There are no other sources of income, and there is no budget deficit, nor profit:

$$X = T + R, \text{ while}$$

---

<sup>18</sup> See Egorov, Guriev, K. Sonin, 2006.

<sup>19</sup> M. Herb, "Representation without Taxation? Rents, Development and Democracy," presented at Georgia State University, December 3, 2003, p. 1.

<sup>20</sup> R. J. Barro, "Determinants of Democracy," *Journal of Political Economy*, 1999, vol. 107, No. 6.

$$X = \sum_{i=1}^N x_i; T = \sum_{i=1}^N t_i; V = \sum_{i=1}^N v_i,$$

where  $V$  is the sum total utility derived from possessing power.

The state is founded upon democratic institutions; i.e., government is effected with the participation of the people and is bound up with the need to cede to the people part of the influence  $\beta$  ( $0 \leq \beta \leq 1$ ). In this particular case, magnitude  $\beta$  is the democracy index. State gain  $\Pi$  as a whole is described by the equation

$$\Pi = (1 - \beta) \times V + (T + R - X).$$

Taking into consideration assumption (4), let us define

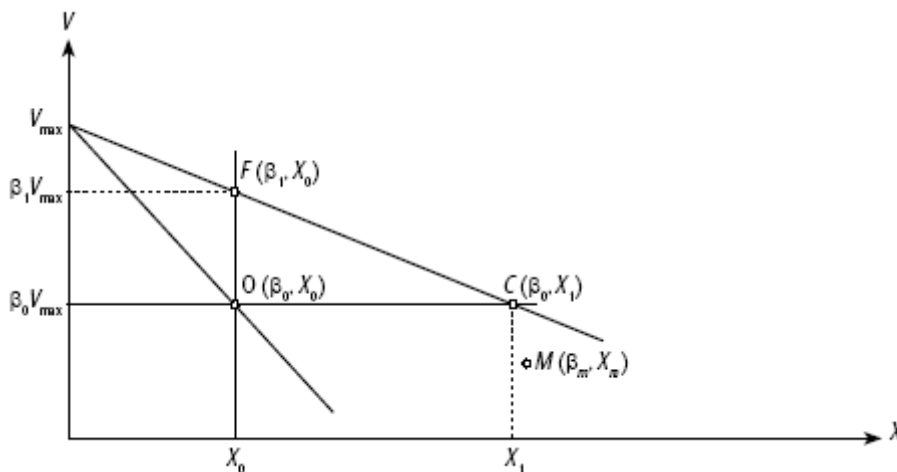
$$\text{Max } \Pi (V, T, R) = (1 - \beta) \times V.$$

The sum total utility for the citizens will then be

$$\text{Max } U = U (\beta V, X, T),$$

where  $U = . \quad U = \sum_{i=1}^N u_i$

The state will always seek ways to impose the maximum restrictions possible on democracy (to lessen  $\beta$ ); that is, to concentrate authority in its own hands. Let it be the case that in some initial situation  $R_0 = 0$ . Then  $X = T$ . The opportunities the state has to decrease  $\beta$  are rather limited, insofar as it has no way to compensate for the utility loss (increasing  $X$  is possible only by means of increasing  $T$ , which will lead to a drop in the overall utility of the citizens ( $\Delta\beta V < 0, \Delta X > 0, \Delta T > 0 \Rightarrow \Delta U = ?$ )). Society therefore stabilizes at point  $O$  with democracy level  $\beta_0$  and public goods quantity  $X_0$  (III. 6.1).



### III.6.1. Voter Corruption Model:

#### Public Choice in the “Authority – Consumption” Space

Suppose that as a result of exogenous change, rent revenue has risen and now amounts to  $R_1$  ( $R_1 > R_0$ ). In cases of standard goods, citizens must make the transition

to budget  $I_{R1}$  and get the opportunity to choose from appropriate combinations of  $\beta V$  and  $X$ , with some combinations including  $\beta > \beta_0$  (for instance, the point  $F(\beta_1, X_0)$ ).

However, rent revenue differs from standard goods precisely in that it constitutes income whose distribution depends exclusively on the government. Now the government, in turn, is not interested in increasing  $\beta$ ; it is therefore willing artificially to limit the possibility of choice making by means of combinations located to the right of point  $C(\beta_0, X_1)$ .

Basket  $C$  is by definition preferable to basket  $O$  ( $\beta_0 = \beta_0 ; X_1 > X_0$ ). Depending on the citizens' utility functions (personal utility functions), a number of additional combinations may obtain ( $\beta_m < \beta_0 ; X_m > X_0$ ), such as that the point  $M(\beta_m, X_m)$  is also preferable to the original basket  $O$ , and possibly also preferable to basket  $C$ .

Thus, when faced with the choice of whether to accept an artificial restriction bound up with the non-increase (diminution) of the extent of the regime's democracy, or to give up income yielded by using profits from rent revenue payments, rationally minded citizens will without a doubt opt for the former. Accordingly, the state's beginning to receive rent revenue income must lead to that the democracy level in the state will not rise, and may even possibly drop in comparison with its "pre-rentier" situation. Note that all this takes place with the fully cognizant agreement of the state's citizens.

A further, even if non-evident consequence is that it becomes important, at what stage of the emergence of the state's institutions the rent revenue first makes its appearance. Insofar as the restriction applying to rent revenue redistribution is a *sine qua non* for the model, taking this artificial step is considerably easier in a society where no institutions have yet taken shape, which regulate the activities of the government. In other words, where no balance has yet emerged, it is considerably easier to change it with a lower level  $\beta$ .

Let us consider the case of the USSR, Russia, Venezuela, Israel, and Norway, which illustrate the model put forth above.

## **Rent Revenue as an Instrument of Voter Corruption: Studying the Examples of Different Countries**

### **USSR in the 1980s and Russia in the 2000s**

As a result of the embargo following the Arabs' defeat in the 1973 war against Israel, OPEC succeeded in provoking a panic on the oil market and a leap in fuel prices. The USSR turned out to be among those who gained the most from the new state of affairs. The principal source of Soviet petroleum in the 1970s came not from the Povolzhye [the Volga Region], nor from the Caucasus, as had been the case earlier, but from Siberia; that is, the overall long-term trend in rising export prices had become manifest by that time. Yet the introduction of new oilfields with enormous petroleum and gas reserves coincided in an extremely fortunate manner with the leap in prices (which grew by a factor of 3-5), while drilling for the petroleum using the least laborious, as well as the cheapest methods made it possible partly to compensate for the drilling and delivery costs, which had risen. In 1982, oil prices for petroleum exports from the USSR broke the record set in 1973, exceeding the figure nine-fold, while the petroleum export growth rate exceeded 60%. The country was swamped as a result, inundated by petroleum dollars, a fact which had a double impact on the development of the Soviet domestic economic-political system in later years. On the one hand, the USSR had acquired a new source of growth for another decade to come.

It was managing to sustain a military-strategic parity with the USA; the country continued to remain one of the two world superpowers.

On the other hand, the stream of petroleum dollars contributed to the substantial destabilization of the Soviet system. Symptoms of the “Dutch disease” began to manifest themselves in the USSR: unilateral development of the export sector, while increasingly weaker attention was being devoted to domestic production (in the case of the USSR, the MIC [Military Industrial Complex] formed an exception).

At the same time, no one can possibly be interested in reform in a situation of this kind, except an incredibly ambitious and responsible leader. But the special interest groups consisting of clerks, who had had the respite to establish themselves after the end of monstrous Stalinist repression (in perfect correspondence with Niskanen’s model) were interested in increasing expenditure projects while maintaining the greatest possible degree of control over production and distribution.

There could thus be no question of directing the extra funds obtained through energy exports to raising the effectiveness of the Soviet economy or to revamping it with any degree of thoroughness (institutionally and structurally<sup>21</sup>). The reforms of 1965-72, limited to begin with, were frozen. Petroleum dollars were being put to use to keep expanding the military potential and the energy sector, as well as increasing the import of traditional sector goods (agriculture, light industry). “Cheap” petroleum income had led the country to an average GDP and standard of living higher than the highest level which the Soviet system could stably supply based on its own internal resources. Petroleum dollars intensified USSR dependence on the condition of the world market. This entailed raising the level of Soviet instability, a fact also reflected in the rapid growth of Soviet foreign debt (the net balance of expenditures needed for servicing the foreign debt came up to \$4.4 billion in 1981, \$5.9 billion in 1984, and \$15.1 billion in 1986). While the West was going through the transformation of traditional industrial society into a post-industrial one, the Soviet system proved unable to adapt to the technological and intellectual challenges of the new era.

Very little was invested in light and food industries throughout the period while the communists were in power. Encountering no problems of demand (a sharp deficit and unlimited opportunities for “writing off” defective or low quality goods left without purchase), the light and food industries witnessed a process of gradual decline. In the end, the problem became so acute that even drastic influx of investment monies (through state subsidies, and therefore ineffective) into agriculture did not help: the condition of this branch of the economy spelled out the must of large-scale grain imports.

A new stage of reforms took off in 1985, when M. Gorbachev came to stand at the helm of authority in the country. An outside push prompting a new stage in the reform process was provided by the drop in world prices for oil: nearly by one half in the course of 1986. Ergo, sustaining the by then evolved system of economic relations became an impossibility. It was initially supposed that economic growth would be accelerated by using a structural maneuver: increasing the share of resources aimed at investment, primarily machine building. But the limitations attendant upon steps of this kind became evident soon enough: such measures needed to be complemented by transformations in the mechanism of the functioning of the economy. Even though the volume of industrial production grew somewhat in 1986-

---

<sup>21</sup> From the point of view of the leadership at the time, the former meant subjecting to risk the authority the leadership then possessed, while the latter without the former spelled out for the economy dealing with investors who would be a priori guaranteed to be irresponsible, as well as not interested in project efficiency.



87 (reaching 4-5%, to be compared with the 1-2% of earlier years), achieving a shift in efficiency remained an impossibility, a circumstance which a priori dictated a dead end to be reached by any further increases in investments unaccompanied by the entrenchment of new incentives.

Besides, the anti-alcohol campaign initiated in 1985 led to additional constraints on the resources pouring into the state budget (constraints besides the drop in oil prices).<sup>22</sup> The country's population was suddenly faced with a sharp drop in real incomes, along with the devaluation of savings at the same time.

Lower oil prices and growing budget deficit prompted M. Gorbachev to take decisive steps to limit dependence on raw materials; the procedure became known as "acceleration." But the desire for increasing growth rates led to an imbalance in the economic system two years later, and, following that, to the system's unraveling.<sup>23</sup>

Ye. Gaydar (2006) used the example of the budget history of the closing years of the USSR to show the mechanisms of obligation proliferation and the "drying up" of incomes. The growing budget deficit provoked an escalation in foreign borrowing. Foreign loans were given, as a rule, in return for guarantees provided by governments of countries opposed to the USSR during the Cold War years. This was a circumstance which made it difficult for the communist authorities to resort to repressions either in the satellite countries or within their own country for the purpose of putting down the growing political instability.

1999 saw the beginning of a new cycle of growth in oil prices. V.V. Putin's government proved the one to gain politically from this process. The rapid cut in debt due to unpaid salaries of state budget employees and pension recipients contributed to the upward climb in support for the pro-government "Yedinstvo" list in the 1999 elections to the State Duma.

At first – for 4-5 years – the reaction of the authorities to the favorable situation was overall reasonable and responsible. There was an emphasis on conducting reforms and stimulating business growth, along with creating a "financial cushioning" to provide a buffer in case of a new crash in oil prices.

Thus, during V. V. Putin's first term in office as President, a law package was introduced dealing with the de-regulation of the economy; a tax reform was put through, which included a flat income tax (one so successful that collection of the tax in question grew substantially).

But then the election campaign as early as 2003 made it clear that if there is no powerful institutional foundation of stable Rule of Law democracy, it is practically impossible to avoid deterioration in the quality of politics or to prevent the unraveling of institutions.

The electoral grounding on which the reforms were based was quickly washed out, with demand on the rise for populist resolutions based on the redistribution of incomes and property "in the interests of the people."

Taxpayer incentives (see Lisin, Yanovskiy et al, Chapter 13 <http://ssrn.com/abstract=2266956> and Attachment 1 to Volume III) were pushed out

---

<sup>22</sup> For further detail, see: I.V. Starodubovskaya, V.A. Mau, 2001; Ye. T. Gaydar, *Dolgoe vremya. Rossiya v mire [A Long Time: Russia in the World]* (Moscow: Delo, 2005), pp. 341-345.

<sup>23</sup> Then again, the government in the 1970s had at least the justification that, at the time, there had practically been no precedent of substantial lowering of oil prices. The situation is essentially different at present: practice has shown that prices for the principal goods in Russian export can both rise and fall; their dynamics are unpredictable. Responsible economic policy must take these considerations into account. However, as we are going to show below, crises resulting from politics of the resource-oriented kind can be traced in economic history in the past, as well; albeit this clearly does not necessarily involve resources belonging to the fuel and energy sector.

by motivating factors with the greatest impact on rent revenue payment recipients (see the model below).

All parties which had passed the 5% barrier, as well as most of those not having made their way into the State Duma, made the issue of rent revenue redistribution and promises to provide rapid increase in wellbeing central to their campaigns. By contrast, the sum total of votes cast in favor of parties not offering to “solve all problems” by means of redistributing the oil rent revenue,<sup>24</sup> even by the most optimistic of evaluations, did not exceed 10.5% (Table 6.1).

Table 6.1

2003 State Duma Election Results

№ п/п	Name of Political Party or Voting Bloc with Registered Federal Candidate Lists	Number of Electoral Votes Cast in Favor of Each Federal Candidate List	
		Total	% of Number of Electors Taking Part in the Voting
1.	“Yedinenie” [“Union”]	710 538	1,17
2.	Souz pravyyh sil [Coalition of Forces in the Right]	2 408 356	3,97
3.	Rossiyskaya partiya pensionerov i partiya sotzial’noy spravedlivosti [Russian Pensioners’ Party and Party of Social Justice]	1 874 739	3,09
4.	Rossiyskaya demokraticeskaya partiya YABLOKO [“Yabloko” (“Apple”) Russian Democratic Party]	2 609 823	4,30
5.	“Za Rus’ svyatuu” [“For Holy Russia”]	298 795	0,49
6.	Obyedinennaya rossiyskaya partiya “Rus” [The United Russian “Rus” Party]	147 423	0,24
7.	“Novy kurs – avtomobil’naya rossiya” [“New Course – Automobile Russia”]	509 241	0,84
8.	Narodno-respublikanskaya partiya rossii [The People’s Republican Party of Russia]	80 416	0,13
9.	Rossiyskaya ekologicheskaya partiya “Zelenye” [The Russian Ecological Party “The Green”]	253 983	0,42

<sup>24</sup> Tellingly, no parties brought up the redistribution of “gas rent revenues.” It is hard not to connect this with the fact that by this time such rent revenues had de facto already been redistributed in favor of the political group in control of the executive authority. “RAO ‘Gazprom’” remains the only natural monopoly and company of nearly no transparency (particularly for an open joint stock company), which is not subject to reform and of which nearly one half also belongs to all citizens (at least nominally).

10.	Agrarnaya partiya Rossii [The Agrarian Party of Russia]	2 205 704	3,64
11.	“Istinniye patrioty Rossii” [“True Patriots of Russia”]	149 144	0,25
12.	Narodnaya partiya rossiyskoy federatzii [People’s Party of the Russian Federation]	714 652	1,18
13.	Demokraticeskaya partiya Rossii [Democratic Party of Russia]	136 294	0,22
14.	“Velikaya Rossiya – Yevraziyskiy Souz” [“The Greater Russia Eurasian Coalition”]	170 786	0,28
15.	Partiya SLON [The “Elephant” Party]	107 444	0,18
16.	“Rodina” (narodno-patrioticheskiy souz) [“Fatherland” (The People’s Patriotic Coalition)]	5 469 556	9,02
17.	Partiya mira i yedinstva [Peace and Union Party]	148 948	0,25
18.	LDPR [Liberal Democratic Party of Russia]	6 943 885	11,45
19.	Partiya vozrozhdeniya Rossii – rossiyskaya partiya zhizni [Rebirth of Russia Party – the Russian Party of Life]	1 140 333	1,88
20.	Politicheskaya partiya “Yedinaya rossiya” [“United Russia” Political Party]	22 779 279	37,57
21.	Rossiyskaya konstituzionno-demokraticeskaya partiya [The Russian Constitutional-Democratic Party]	113 184	0,19
22.	“Razvitie predprinimatel’sstva” [“Business Development”]	212 825	0,35
23.	Kommunisticheskaya partiya rossiyskoy federatzii (KPRF) [The Communist Party of the Russian Federation (CPRF)]	7 647 820	12,61
Number of electoral votes cast against all federal candidate lists		2 851 600	4,70

Source: CEC RF [Central Election Commission of the Russian Federation], Political Parties and Blocs Programs in the 2003 Elections to the SD [State Duma], <http://gd2003.cikrf.ru/partii.html>

All in all, taking into account the incidence of cases of rational ignorance, it is senseless to expect that voters who do not at present connect their suffrage with

paying taxes, will have long-term assessments of perspectives of development of the economic and Rule of Law systems. Limited political experience (in a country with no tradition of democracy or long-term experience of Rule of Law democracy) does not provide such voters with the grounds to perceive political rights and freedoms as an autotelic good. Under conditions such as these, the behavior of the Russian voters may be acknowledged as fully rational.

The models and approaches discussed in studies devoted to the comparative institutional development of different Russian regions and post-socialist countries,<sup>25</sup> which have been introduced briefly above (see Introduction), predicted with a high degree of probability a considerable deterioration in the entrepreneurial climate even in the medium-term perspective. Given conduct of this kind on the part of the electorate, incentives for the authorities to carry on economic and profound institutional reforms, including support for independent courts and press, safeguards of personal immunity, reform of the military and law enforcement agencies, are all undermined. Due to the absence of pressure by the press, the opposition, foreign creditors, or MFOs [micro-financial organizations], even incentives for introducing a basic responsible tax-budget policy are weakened.

By contrast, motivation becomes stronger to mobilize political support not among the most dynamic part of society, but among the most socially vulnerable citizens: state budget district doctors (who had benefited from some of the elements involved in the national “*Zdorovye*” [“Health”] project<sup>26</sup>), retirees living in small towns and rural areas (thus, the monetization of special discount privileges, which dealt a blow to retiree residents of large cities, was overall profitable for those population age group categories for whom free public transportation was not a real option either because no public transportation was available, or due to the small size of their town or hamlet).

Regrettably, there are as of yet no grounds for supposing that the forecast is not being justified. If oil prices do not go down appreciably in the medium-term period, deterioration in business climate can prove long-term. In case of a sharp drop in oil prices, a considerable rise in demand for institutions providing Rule of Law democracies with long-term advantages should be expected (assuming Russian voters are rational) after a certain time lag. The growth in demand can (albeit also with a certain lag in time) open the next “window of opportunity” for continued reform.

## Venezuela

Venezuelan economy had become addicted to the rent revenue payment drug before the same thing happened to other oil-exporting countries: in Venezuela this took place as far back as the early 1930s. By 1935, income from oil concession sales to foreign companies brought Venezuela to first place in Latin America in per capita DNP levels.<sup>27</sup>

Approximately the same period also saw the beginning of the formation process of Venezuela’s political institutions. This statement, once made, calls for additional clarification. Most researchers consider 1958 to be the point when Venezuela’s

---

<sup>25</sup> Mau, Javoronkov, Yanovskiy, et al. 2002; Mau, Javoronkov, Cherny et al., 2002.

<sup>26</sup> See comments on the site of the Council for Implementing Priority National Projects and Demographic Policy at the Russian President’s Office: <http://www.rost.ru/projects/health/p02/p21/a21.shtml>.

<sup>27</sup> Lagoven1993.

political system in its modern guise began its existence.<sup>28</sup> In our view, taking this as the point of departure is a mistake; the moment rather marks the completion of the process of the formation of political institutions.

The foundations of Venezuela's political institutions were laid as far back as the days of Simone Bolivar.<sup>29</sup> Even so, the years from 1935 until 1958 may not simply be labeled as the period of reforming, but rather, shall we say, as the stage of institutional genesis.

The dictator J.V. Gomez died in 1935 after 27 years in power. In the course of the following 23 years, authority over the country switched hands 8 times, of which, incidentally, only two were peaceful. Clearly enough, all this was not in the least due to the personalities of the leaders, but had reasons reaching deeper down. Prior to the surfacing of the oil factor, Venezuela had been an agrarian state with a predominantly illiterate population. Oil changed the situation drastically. High salaries at petroleum drilling stations prompted rural workers to leave the land. As a result, changes in the demographic makeup of the population took place, along with the emergence of the need to import basic foodstuffs, a development which made the cost of living in Venezuela one of the highest in the world.<sup>30</sup>

The institutions in existence at the time were not outfitted to handle the altered reality. A series of uprisings, upheavals, and social experiments – from general elections to a full ban on parties and the free press – were the outward manifestations of a transition period in which power relationships and rules of the game were being established. This period came to a close with a pact which came to be known as the *Punto Fijo*.

The *Punto Fijo* pact is considered the beginning of Venezuelan democracy; it consists of a series of agreements concluded in 1958-61 by the leadership of the largest parties. The goal of the agreements was to bring to a close the period of tension among the key players, and to create a mechanism of peaceful redistribution of influence among them. Time demonstrated the practicability of the pact: for more than 30 years, Venezuela remained “the most stable democracy in South America.”<sup>31</sup> However, it is the very nature of the democracy involved that raises serious doubts.

Thoroughly untypical for a democratic tradition is the makeup of the forces which the pact granted access to ruling the country by means of the appropriate mechanisms; albeit it is true that the situation does look logical in light of earlier developments. Besides the three leading parties (the Social Democratic AD, the Social Christian COPEI, and the leftist nationalist URD), the coalition included trade unions, the Catholic Church, and the military; that is, organizations little dependent on the voters.

The regime established in Venezuela could be called democratic only based on the elections regularly conducted in the country. But the elections were rather a fiction. De facto rule over the country was in the hands of the Parliamentary Committee, which, as per the Constitution of 1961, was composed of 8 AD members, 4 COPEI members, 4 members of the URD, 3 communists, and 3 independent candidates – *regardless of election results!*

The impact which the voters could have on government policies, as realized via their parliamentary representatives, was minimal. The elections system left all

---

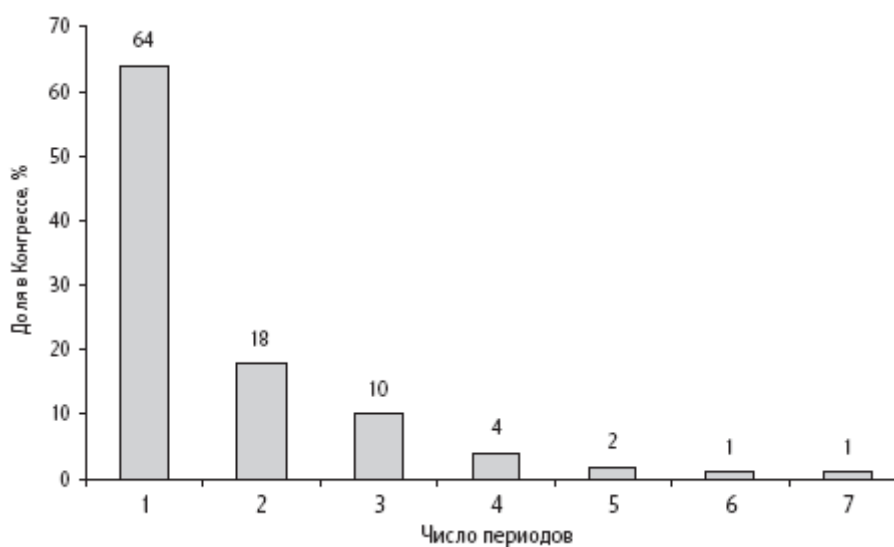
<sup>28</sup> D. Canache, M.R. Kulisheck, *Reinventing Legitimacy: Democracy and Political Change in Venezuela* (Greenwood Publishing Group, 1998), p. IX.

<sup>29</sup> Simone Bolivar was President of Gran Colombia (1818-1830), of which Venezuela formed a part.

<sup>30</sup> “History of Venezuela,” *Collier's Encyclopedia*, <http://www.diclib.com/cgi-bin/d1.cgi?l=ru&base=colier&page=showid&id=2363>.

<sup>31</sup> US Department of State Background Note: Venezuela <http://www.state.gov/r/pa/ei/bgn/35766.htm>.

authority in the hands of the party leadership, which had chosen the candidates for the pre-elections list. This is bespoken by the fact that 60% of the members of Parliament spent one term working in Congress (Ill. 6.2). The fate of the land was decided by a mere 8.3% of the members of Parliament, who had been elected to Congress for over 20 years, with 80% of them belonging to the country's leadership, to boot.<sup>32</sup>



From: Rubio Mar 2002.

### III. 6.2. Number of terms served in Congress by members of Parliament (1958-2000)

It is no overly complex task to trace the connection between oil rent revenue and the political system established in Venezuela. Two of the four non-parliamentary players shaping the country's future (the trade unions and the industrialists) were de facto representatives of the oil branch of the economy. Yet immeasurably more important is that the ideological unification (typical of the Russian policies as well, beginning in 2003, i.e., during the period of high and rising oil prices) reduced the real opportunities of choice making to a minimum.

The subsequent fate of Venezuela's political system conforms to the standard among rentier economies. High-level spending on public goods and ambitious projects for raising the level of welfare, ignoring the budget deficit based on anticipated future income, and the outcome: economic trouble.<sup>33</sup> A sharp drop in oil prices in the late 1980s led to the crash of the system, plunging the country into a succession of putsches and disturbances.

The 1998 democratic coming to power of Hugo Rafael Chávez Frías (who had previously headed one of the unsuccessful putsches) and the measures which he implemented aiming at the political stabilization of the regime and based on a moderately authoritarian approach (increased social spending: subsidies for the poor strata of the population; nationalization of various profitable enterprises and the elimination thereby of sources of financing for the opposition; limiting the activities

<sup>32</sup> The foundation upon which the wellbeing of the three largest parties depended – a generous supply of public goods – required that income from oil rent revenue be sustained constantly.

<sup>33</sup> For further detail on the regularities in the development of rentier economies, see Ye. Gaydar, "Gibel' imperii: Uroki dlya sovremennoy Rossii" ["The Death of an Empire: Lessons for Contemporary Russia"], in *Rossiyskaya politicheskaya entziklopediya [The Russian Political Encyclopedia]* (Moscow, 2006); Mau 2010.

of private electronic mass media, concomitantly with the expansion of state mass media instead; and corruption-related legal proceedings against disloyal governors) intensified the trend toward a “closing” of the democracy.

Coming back to the model first proposed at the outset, let us note the following: Venezuela’s political system was constructed under the powerful influence of the rent revenue payments factor; Venezuela is primarily characterized by a low level of democracy in conjunction with a high level of supplying public goods. The outcome of constructing such a system tallies perfectly with the outcome predicted by the model.

## **Mexico**

While studying the genesis of the rentier economy in Mexico and its impact on the political institutions of this state, it is impossible to pass over without noting the obvious similarity between many of the episodes in this process with their analogues in Venezuela and Israel. But the Mexican case stands out due to some rather singular moments.

The most important feature distinguishing Mexico from other rentier economies is the fact of its having tried to step into the same river twice.

Mexico has been a supplier of silver and other minerals since as far back as the times of Spanish dominion. In the 1860s, it was the world’s largest exporter of silver.<sup>34</sup> Even so, the period of Mexico’s economic growth period did not begin until the late 19<sup>th</sup> century, under the dictator P. Diaz, who ruled the country from 1876 until 1910.

During this period, the per capita GDP in Mexico was approximately equal to that of Argentina and three times as large as the same indicator in Brazil and Venezuela.<sup>35</sup> Mexico’s economy averaged 3.3% growth per annum.<sup>36</sup> Diaz succeeded in achieving stability in the country and modernizing its infrastructure.

But delving analytically deeper brings out considerable structural problems in both the economic and the social spheres. Favorable economic growth indicators were obtained largely thanks to natural resources exports. All other macroeconomic indicators showed Mexico to be lagging far behind other countries, such as Argentina. Microeconomic analysis of data from various production sectors indicates their lack of development, as well as shows symptoms of the “Dutch disease.”<sup>37</sup> Modernizing the infrastructure and raising the standard of living of the population had an impact primarily on the Northeastern part of the country, which is the wealthiest in natural resources and which shares a border with the US. All this along with the regime’s corruption created a condition of inner tension within the country, which ultimately led to the revolution of 1910.

Begun as a protest against the Diaz dictatorship, the revolution grew into a civil war involving many sides, including the US and Germany. Each of the warring sides aimed to achieve control over rent revenue payments, for instance, by maintaining

---

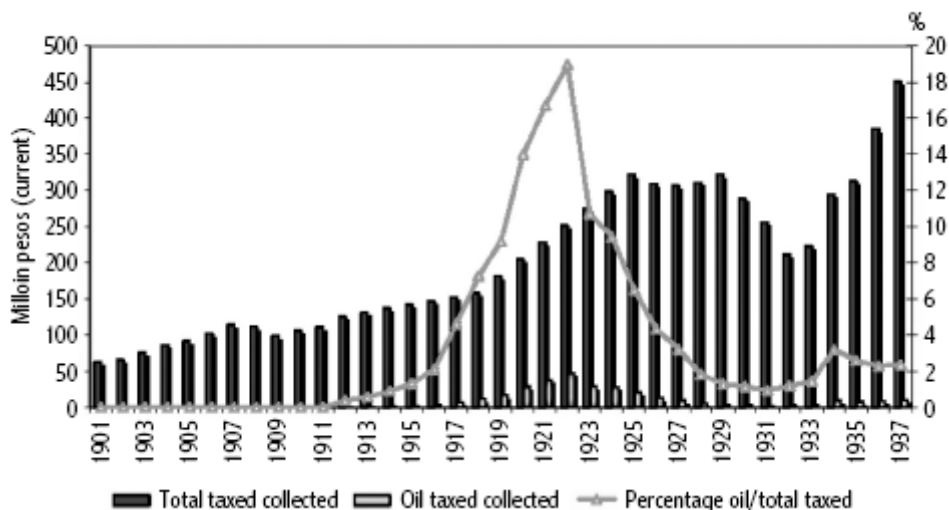
<sup>34</sup> C. Marshal, *The Experience of Banamex: French Bankers and Banking Models in Mexico, 1884—1900. Paper Prepared for Session 102 of the XIV IEHA World Congress* (Helsinki, August 2006).

<sup>35</sup> G.E. Perry, J.H. Lyepez, W.F. Maloney, et. al., *Poverty Reduction and Growth: Virtuous and Vicious Cycles* (Washington, DC: The International Bank for Reconstruction and Development / The World Bank, 2006), p. 148.

<sup>36</sup> *Desarrollo Economico*, retrieved on Feb. 17, 2007.

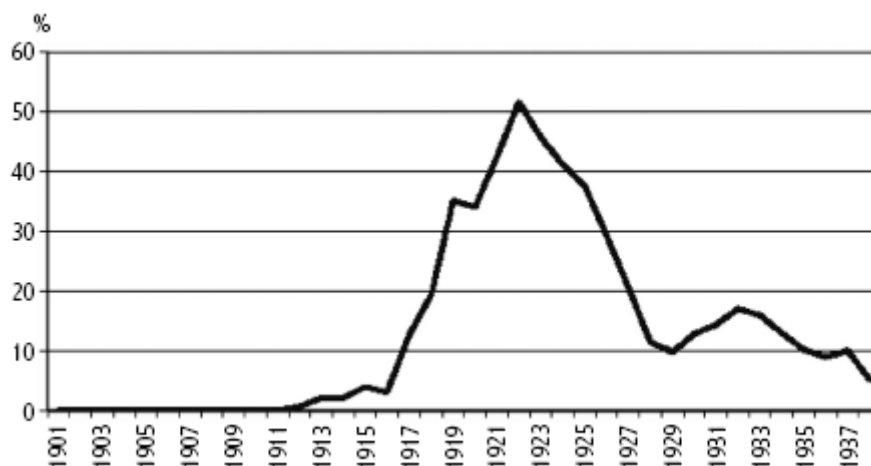
<sup>37</sup> A.V. Catro Luis, “Mexico and Export-Led Growth: The Porphyrian Period Revisited,” *Cambridge Journal of Economics*, vol. 22, N. 1 (1998), pp. 59-78.

physical control over regions where the natural resources were being drilled for.<sup>38</sup> Pursuit of this objective was provided with an additional incentive when a new direction took shape in the Mexican economy. Petroleum was the issue at stake. III. 6.3 and 6.4 show how rapidly this factor gained in prominence.



From: M.d.M. Rubio Varas 2002, Appendix C: Fiscal Obligation (M.d.M. Rubio Varas, 2002).

**III. 6.3. Petroleum taxes as a percentage of the total taxes collected<sup>39</sup>**



From: M.d.M. Rubio Varas 2002, Appendix B: Export Dependence Series' in (M.d.M. Rubio Varas, 2002).

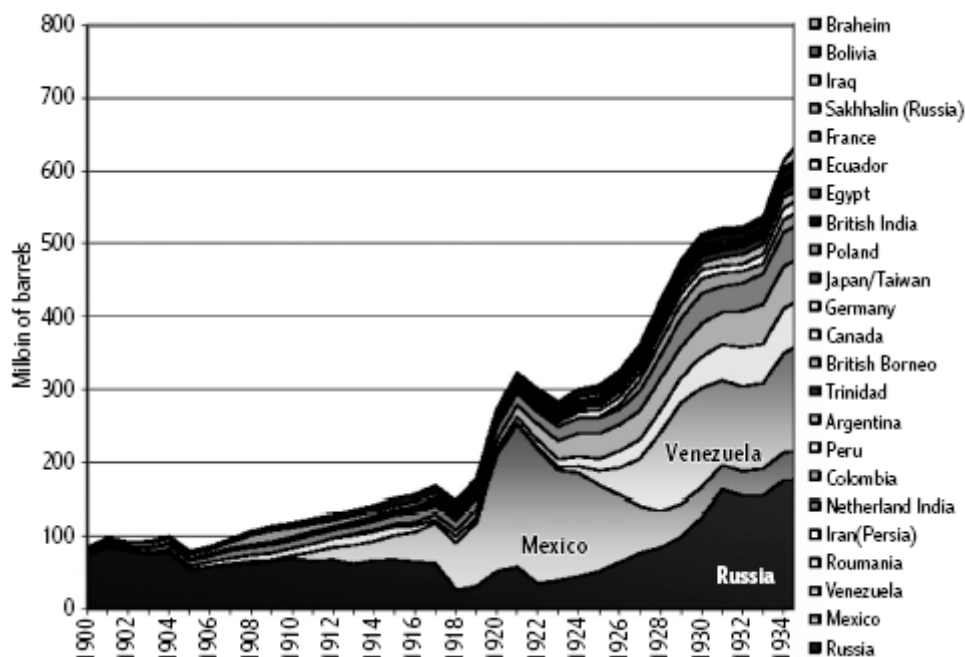
**III. 6.4. Income from petroleum exports as a percentage of total income from export<sup>40</sup>**

<sup>38</sup> J. Hart Mason, *Revolutionary Mexico: The Coming and Process of the Mexican Revolution* (University of California Press, 1997).

<sup>39</sup> M.d.M. Rubio Varas, *Towards Environmental Historical National Accounts for Oil Producers: Methodological Considerations and Estimates for Venezuela and Mexico over the 20th Century* (PhD, London School of Economics, 2002), Appendix C.



Oil drilling and oil exports first became subject to taxation in 1912.<sup>41</sup> Following the ratification of the Constitution in 1917, the government had the right to monopoly ownership of the state's subterranean possessions. During this period, Mexico became one of the largest world suppliers of petroleum (second after the US; see III. 6.5).<sup>42</sup> Practically all the petroleum obtained was exported.<sup>43</sup> The influx of monies into the state budget (petroleum rent revenue) grew accordingly.



From: Rubio Mar 2003

### III. 6.5. World Petroleum Production beyond US Borders 1900-1936

However, the struggle for power and control over the country did not come to an end even after the Constitution had been ratified – a stage of some significance in the formation process of the new political institutions. Following a few years of stability, Mexico was again shaken by a series of wars, revolutions, and political assassinations.<sup>44</sup> These came to an end only in 1929, with the creation of the Institutional Revolutionary Party (the PRI) and the establishment of a single-party political system in Mexico.

The system created by the PRI and President Lázaro Cárdenas<sup>45</sup> remained in existence with almost no alteration until the mid-1980s. A study of the system shows a strong similarity between it and comparable setups in Venezuela and Israel, even though the Mexican system also has a number of distinctive features of its own.

The first significant peculiarity of the system consisted in its ability to provide stability of the ruling elite independently of election results. In Israel, the Labor Party

<sup>40</sup> M.d.M. Rubio Varas, 2002, Appendix B.

<sup>41</sup> M. Rippey, *Oil and the Mexican Revolution* (Leiden, 1972), p. 137.

<sup>42</sup> Rubio Mar, "Oil and Economics in Mexico, 1900-1930," *UPF Economics & Business Working Papers*, N 690 (May 2003), p. 8.

<sup>43</sup> *Ibid.*, p. 3.

<sup>44</sup> S.H. Haber, N. Mauer, & A. Razo, "When law does not Matter: The Rise and Decline of the Mexican Oil Industry," *The Journal of Economic History* 2003: 63 (1), pp. 4-5.

<sup>45</sup> Lázaro Cárdenas, Mexican President 1934-1940.

achieved the same result by forming coalitions which any party could join, thus doing away with potential motivation for steps which could be taken by an opposition party.<sup>46</sup> In Venezuela, the status quo provided the Parliamentary Committee mentioned above with a permanent set of members.

The Mexican version is closer to the Israeli (or rather, taking the time factor into account, the Israeli variety is closer to the Mexican), but with a correction in view of the single-party system. All of the country's presidents were PRI members, with each one simply replacing his predecessor in office every six years to accord with the Constitution. The new president could always belong to either the right or the left wing of the party. In this way, all of the different possible subgroups were encouraged to remain united under one roof. Clearly enough, the candidate for future president was chosen by the party leadership; it would also frequently be the case that the president incumbent would appoint his own successor.<sup>47</sup>

Stability of authority was also provided for by ensuring total control over all sources of influence, including the executive and the judicial authorities. The army had its representatives in the military section of the party.<sup>48</sup> Television was owned by the families of two leading PRI party functionaries. Property rights were not unambiguously defined by the Constitution, a circumstance which increased the dependence of private entrepreneurs on party officials.<sup>49</sup>

Control over rent revenue payments made to the state transferred entirely into the hands of the government. In 1938, President Lázaro Cárdenas nationalized the oil refining branch of the economy. The Mexican government got the exclusive right to drill, produce, refine, and sell petroleum and gas, as well as produce and sell key petroleum chemical products.<sup>50</sup>

The regime established by the PRI could be marked a standard one for the rentier type of economy. But the paradox consists in that by the time the regime was established, Mexico was no longer an economy of this kind. The long period of instability had done its share. As can be seen in Ill. 6.3-6.5, the drop in Mexican oil production was no less sharp than its rise had originally been. By 1938, the share of petroleum income in exports had dropped to approximately 5% (from 50% in 1922), and to 2% in taxes collected (from 19% in 1922).

Mexico's dependence on petroleum rent revenue continued to decrease in subsequent years; by 1957, the country had become a net importer of petroleum.<sup>51</sup> Mexico's economic growth in 1930-1970, dubbed the "Mexican miracle," is not in any way connected to rent revenue payments made to it.<sup>52</sup>

A new petroleum boom took place in 1973-74, coinciding with the discovery of new oilfields in Mexico.<sup>53</sup> The country once again obtained an enormous and apparently inexhaustible source of income.

As is evident from Table 6.2, the second transformation of Mexico's economy into an economy of the rentier type took place more rapidly than at the beginning of

---

<sup>46</sup> See, for instance, data concerning the makeup of the coalition on the official Knesset site at: <http://knesset.gov.il/govt/heb/GovtByNumber.asp>.

<sup>47</sup> Mau, Yanovskiy, Javoronkov et al. 2007.

<sup>48</sup> The PRI originally included four sections: the agriculturalists', the workers', the people's national, and the military; <http://www.krugosvet.ru/articles/63/1006344/1006344a3.htm>.

<sup>49</sup> Mau, Yanovskiy, Javoronkov, Zatkovetcky et al. 2013.

<sup>50</sup> According to Federal Investigation Department at the Library of Congress data, quoted on the site at: <http://www.country-studies.com/mexico/oil.html>.

<sup>51</sup> <http://www.country-studies.com/mexico/oil.html>.

<sup>52</sup> Gaydar 2006.

<sup>53</sup> <http://www.country-studies.com/mexico/oil.html>.

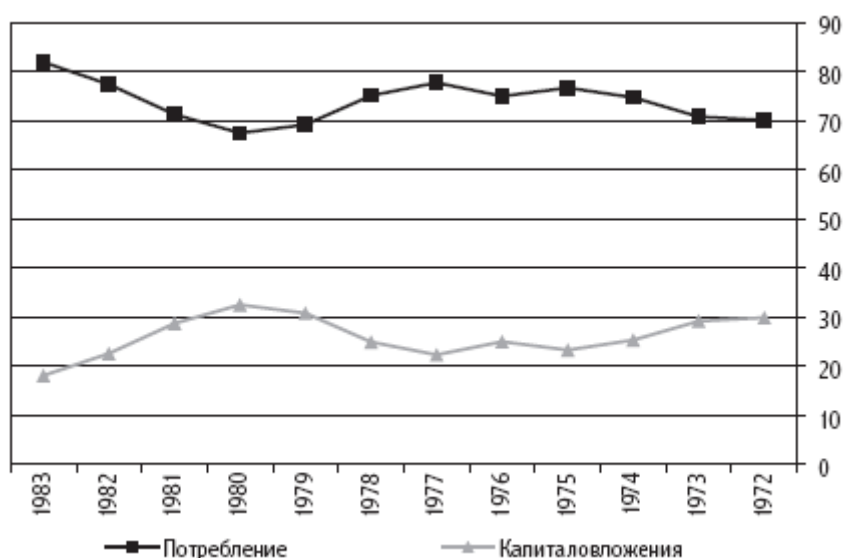
the century, while dependence on rent revenue payments became even more complete.

Table 6.2

Income from Petroleum Exports as Percentages of Total Income from Export

Год	%
1970	2,7
1975	15,8
1980	63,1
1985	66,6

Source: IMF, International Financial Statistics



Source: IMF, International Financial Statistics, Supplement on Government Finance (1986) (black line – consumption; grey line – investments)

### III. 6.6. Structure of State Spending in the Mexican Government

Subsequent PRI policies form an ideal fit with the behavior models suggested above for governments in receipt of rent revenue payments. Increased income leads to a different set of priorities: operations supplying public goods go up, with the government financing a multitude of projects aimed at “buying” votes (Ill. 6.6). The percentage of state expenditures devoted to consumption has a stable growth tendency.<sup>54</sup> The growth of capital investments in 1977-1980 is really an optical illusion. What was at stake in reality at this time was a sharp jump in investments in

<sup>54</sup> Mau, Yanovskiy, Javoronkov et al. 2013.

exploration and drilling for oil. Investment in other branches of the economy was actually going down (Table 6.3).

Table 6.3

Structure of Government Spending in Mexico in Areas of Capital Investment

Year	Oil, %	Other Branches, %
1975	20,5	79,5
1978	51,9	48,1
1979	52,9	47,1
1980	49,1	50,9
1981	55,9	44,1

Source: N. Usui, "Dutch Disease and Policy Adjustments to the Oil Boom: A Comparative Study of Indonesia and Mexico," *Resources Polio*, vol. 23, N 4 (1997), p. 156.

Subsequently, the scenario was also no different from the standard road followed by developing rentier economies: large-scale projects required large-sized borrowing abroad, with the result that Mexico's foreign debt increased (Table 6.4), the economy began to unravel, with the drop in oil prices coming as the economy's total and definitive undoing. But in connection with our concerns here it is important to note that petroleum rent revenue and the "buying" of votes associated with it made it possible for the PRI regime to maintain its former level of closed functioning, without delegating any additional authority to the voters.

Table 6.4

Mexican Foreign Debt

Year Год	Foreign Debt, % of GDP	Short-Term Loans, % of Imports
1978	12,0	33,5
1980	14,1	48,9
1981	15,5	55,9
1982	24,8	76,7

Source: IMF, International Financial Statistics

Summarizing briefly the upshot of the analysis of these three periods of Mexico's dependence on rent revenue payments, we should note their clear resemblance to each other. At an early stage of its history, income from the sale of underground natural resources led to the establishment of the Diaz dictatorship, with the dictator for more than 30 years "buying" peace and quiet in the country by providing an intensified supply of public goods. At the beginning of the 20<sup>th</sup> century, the appearance of "petroleum money" impacted the process of transforming the

liberal regime proclaimed after the revolution of 1910, into a closed PRI semi-dictatorship. In the 1970-80s, Mexico again became the possessor of “petroleum money.” And again the “purchase” of enormous numbers of voters maintained the non-democratic PRI regime, perfectly in correspondence with the model here being proposed.

### Norway

Unlike the countries described above, in Norway the formation of political institutions was complete long before any stable rent revenue payments had made their appearance. The present Constitution went into effect in 1814. The head of the state is the king. The king is the holder of executive authority; he is also formally the holder of considerable rights and power: he appoints the government, he heads the Armed Forces, he declares war, he concludes peace, and he has the right of imposing a deferral veto, and so on. But de facto executive authority in the land is exercised by the State Council (the government), while the king merely confirms its decisions with his signature. Storting (the Parliament) is the highest body of the legislative authority in the land; it is made up of 165 deputies elected for 4-year-terms on the basis of a proportionate system. The Parliament cannot be disbanded in advance of its set term.

In its present form, the court system is an heir of the *Thing* (the people’s assembly); it is for this reason characterized by little-codified laws and recognizes custom as an important source of the law. Appointment to judges’ posts in the general courts and in the majority of the special courts is done by the king based on the recommendation by the Minister of Justice; appointment is for life but with retirement compulsory at the age of 70. All in all, Norway’s institutions are characterized by stability and balance.

Norway’s political life is no less stable. The largest political party in Norway is the Norwegian Workers’ Party (the NWP, or the *Arbeiderpartiet*, the Labor Party). It was founded in 1887 as a social-democratic party, and obtains its support primarily from the professional trade union movement. In 1919-1923, the party was part of the Communist International, which it left due to disagreement with the centralization and foisting of Bolshevist tactics. Thereafter, the *Arbeiderpartiet* again began to operate as a social-democratic party. It is part of the Socialist International. The ideological foundation of the *Arbeiderpartiet* is democratic socialism. In 1945-1963, the party remained in power without interruption. Subsequently it usually formed the government ruling the country, with the exception of a few short spans of time when rightist-centrist coalitions were in power (1963, 1965—1971, 1972—1973, 1981—1986, 1989—1990).

The mass media market is also distinguished by stability: the leftist-oriented state TV and radio broadcasting, accounting for 90% of the audience, and the wide spectrum of opinion in the paper printed publications.

The exact date when Norwegian economy became a rentier state economy is hard to pinpoint. But we can say that petroleum rent revenue began to become more and more significant for the economy of the country in the early 1980s (Table 6.5).

Table 6.5

Petroleum Production Industry Statistics in Norway

\*

Year	Production		Consumption		Volume of Oil
	Gas	Petroleum	Gas	Petroleum	

			m			m	Refinery Plants, million tons per annum
	Billion cubic meters	Million Tons Oil Equivalent	Million tons	Billion cubic meters	Million Tons Oil Equivalent	Million tons	
1970	—	—	—	—	—	8,3	9,7
1971	—	—	0,3	—	—	8,2	8,1
1972	—	—	1,6	—	—	8,5	8,7
1973	—	—	?????	—	—	8,6	8,4
1974	—	—	1,7	—	—	7,7	8,4
1975	—	—	9,2	—	—	8,0	12,9
1976	—	—	13,8	—	—	9,0	12,9
1977	3,1	2,8	13,6	0,4	0,3	8,9	13,2
1978	14,9	13,4	17,0	0,6	0,6	9,3	13,0
1979	21,6	19,4	18,8	0,7	0,7	9,6	13,0
1980	26,0	23,4	24,5	0,8	0,7	9,3	12,5
1981	26,2	23,5	23,5	1,0	0,9	8,7	12,0
1982	25,5	23,0	24,5	1,0	0,9	8,3	12,0
1983	25,8	23,2	30,5	1,2	1,1	8,3	12,0
1984	27,4	24,6	34,7	1,1	1,0	8,6	12,0
1985	25,3	22,8	38,3	1,2	1,1	9,0	12,0
1986	27,0	24,3	42,5	1,3	1,2	9,3	12,0
1987	29,7	26,7	49,5	1,4	1,3	9,7	12,0

1988	29,8	26,8	56,2	1,8	1,6	9,2	10,5
1989	30,8	27,7	74,5	2,0	1,8	9,0	13,0
1990	27,8	25,0	81,7	2,1	1,9	9,2	14,6
1991	27,3	24,6	93,3	2,4	2,2	8,7	14,4
1992	29,4	26,5	106,9	2,6	2,3	9,0	14,4
1993	28,9	26,0	114,1	2,7	2,4	9,5	14,4
1994	30,8	27,7	129,4	2,9	2,6	9,6	14,4
1995	31,2	28,0	138,5	2,9	2,7	9,6	14,9
1996	41,0	36,9	155,5	3,2	2,9	10,1	15,4
1997	46,7	42,0	156,9	3,7	3,3	10,3	15,4
1998	47,8	43,0	150,0	3,8	3,4	10,0	15,5
1999	51,0	45,9	149,4	3,6	3,2	10,1	16,1
2000	54,0	48,6	160,5	4,0	3,6	9,4	15,9
2001	57,5	51,7	162,1	4,5	4,0	9,7	15,2

\* Compiled based on: *Official Energy Statistics from the U.S. Government* (Washington: Energy Information Administration, 1970-2001)

No changes of note took place in the political system in the two-and-a-half decades since the introduction of raw material rent revenue into the Norwegian economy. No important additional elements were introduced into the Norwegian Constitution, the relative weights of the principal players on the political scene were not altered in any significant way, the court system became neither more, nor less, independent, and nobody increased nor weakened the control exercised over the press.

Some changes of significance took place among the large parties involved in the elections to the Storting. We must first of all note the unraveling of the ideological

position assumed by the *Høyre*, the leading conservative party. The motives for the disintegration are clear enough: when the state is in a position to permit itself the provision of public goods in sizable quantities and without endangering the voters' purse, there is no point in defending conservative values. Competition on the political market has thus dropped sharply, seeing as the two leading parties have practically reduced their differences to a minimum.

Yet another change is bound up with the attitude toward rivals, or, to be more precise, toward the Party of Progress, a conservative party with a clearly displayed ideology (market economy, cutting taxes, limited state spending, and struggle against international terrorism). For the first time in Norwegian history, a party this influential (22% of the vote in the 2005 elections) is not taken into consideration as a legitimate coalition partner. Representatives of the establishment describe it as fascist, a rhetorical move out of touch with reality. In this particular case, we are confronted with organized hunting down of an ideological opponent – a phenomenon typical of authoritarian regimes. It is no challenging task to trace the connection between attacks against the Party of Progress and rent revenue. Consider just that by calling for cuts in state spending, the “new conservatives” endanger the existing level of authority, which is concentrated in the hands of the establishment.

Summing up what has been stated thus far, we can say that Norway provides the most likely and appropriate illustration for the claim that rent revenue lowers the level of democracy in a state, but the extent of the damage depends on the degree of the country's institutional ripeness. In Norway as a state in possession of ripened stable institutions, this damage proved to be not especially significant (at least in the medium-term perspective), but not negative, nonetheless – just as had in fact been forecast by the model.

It is important to note that raw material rent revenue is the most common source of the disintegration of effective institutions and reasonable policy, albeit not the only one. The following example provides an obvious instance of an exception.

### **Israel<sup>55</sup>**

The gestation process of modern Israeli state institutions differs from the same process in other countries. Its special features are most vividly conveyed by a phrase coined by I. Zangwill: “A land without a people for a people without a land.”<sup>56</sup> From the day of its inception, the Zionist movement saw as its goal the restoration of the Jewish state in the “Land of Israel” and the ingathering of the Jewish People in it. State institutions thus began to assume their shape while the majority of the Jewish People was outside Israel's borders. All sources of financial support (as well as the electoral base) of these institutions thus also had no connection with the population of the country.

---

<sup>55</sup> Among post-Soviet countries, there are a number of states where monetary influx from abroad plays a significant role: consider Armenia, Moldova, or Kirgizia. Resources of this kind are almost entirely unconnected with steps taken by governments (it is simple enough not to put obstacles in the way of individuals' free departure or receipt of money transfers from abroad). In Armenia, a considerable part of these monies end up subject to government control. “Unearned” money of this kind provides the authorities with motivation of the same kind that Israeli authorities have. But insofar as the time period when this situation could be observed has thus far been relatively short, the present study will not devote any detailed discussion to the case of Armenia.

<sup>56</sup> <http://www.ynet.co.il/yaan/0,7340,L-12998-PreYaan,00.html>.



The World Zionist Organization (WZO) constituted the highest agency of authority for the Zionist movement, with the WZO leadership elected by the World Jewish Congress.<sup>57</sup> The WZO's executive agency, the Jewish Agency for the Land of Israel (JAFI), functioned as a government of sorts for the Jewish population in Palestine ruled by the British Mandate. Its activities included, inter alia:

- Representation of the Jewish population of the Land of Israel before the Mandate authorities, other countries, and Jewish communities throughout the world;
- Collecting money for the construction of the Jewish state;
- Leadership of local councils in the Land of Israel;
- Management and coordination of the education system; and
- Management and coordination of the chief rabbinate.<sup>58</sup>

Insofar as JAFI's primary goal consisted in creating a state, it concerned itself with Jewish immigration into Israel, in addition to controlling all large-scale economic activity both by means of financing enterprises and via the Workers' Union (professional trade union), which was also coordinated by JAFI.<sup>59</sup>

Let us note some of the issues involved in greater detail. First of all, Jewish immigration into Israel was limited during nearly all of the period of the British Mandate.<sup>60</sup> This means that the arrival of new immigrants could take place either legally, in accord with the quotas specified by the British authorities for the Jewish Agency, or illegally, via channels created by the selfsame Jewish Agency. The situation permitted the Jewish Agency leadership to take advantage of all opportunities for choosing the candidates in their view most fitting for the status of future residents of Israel.

Secondly, a question arises in connection with representing the Jewish population before the British authorities. In a situation where sources of tension were perpetually active, the Jewish Agency leadership could easily cast opposition to itself as the enemy of the British Mandate (especially considering that this often was the case in reality). It thus enjoyed the special privilege of sorts, provided by its status as a legitimate partner, of watching the English destroy its rivals (and sometimes of even assisting them in this, thus fortifying its own position vis-à-vis two different opponents at the same time).<sup>61</sup>

In this way, Israel's institutions, created, in effect, exclusively at the expense of the rent revenue obtained from the Jewish diaspora, were distinguished by a critically low level of democracy. By the time the State was proclaimed, all authority in it was de facto in the hands of an organization appointed from abroad. The inhabitants of the country decided next to nothing in practice, but – as if in recompense – were the object of the care provided by the system in all walks of life: in work, education, health care, and more.

The proclamation of the state was in theory supposed to alter the balance of forces thus established. Support from the West and the American diaspora spelled out the must of endowing the country with a democratic profile. The bulk of the Jewish Agency's rights and authority was transferred to the government, which was voted in

---

<sup>57</sup> "Zionist Organization", [http://www.worldjewishcongress.org/en/about#tab\\_1](http://www.worldjewishcongress.org/en/about#tab_1); <http://www.zionistarchives.org.il/en/Pages/Default.aspx>.

<sup>58</sup> "The Jewish Agency", <http://www.zionistarchives.org.il/en/Pages/Default.aspx>.

<sup>59</sup> "*Histadrut ha-ovdim ha-klalit ha-chadashah*" "The Workers' New General Union".

<sup>60</sup> The British White Paper of June 1922, <http://www.yale.edu/lawweb/avalon/mideast/brwh1922.htm>.

<sup>61</sup> <http://www.etzel.org.il/ac07.htm>.

by means of general elections. This was supposed to portend a turning point in the situation in the country, or at least, the beginning of the process of democratization.

In practice, the institutions of a rentier economy prevented a rise in the level of democracy. David Ben-Gurion, the leader heading the Jewish Agency, became head of government. The same people (most of them members of the Labor Party) remained in power. The mass media, controlled by the government, ignored the existence of opposition parties, thus preventing them from presenting their views. In 1948, all those officers who were associated with movements opposing the Hagganah, which served as the Labor Party's armed organization, were dismissed from military leadership posts.<sup>62</sup> In addition, the SHABAK, or counter-intelligence, took care of sleuthing after party leaders and following them around.

At the same time, the state implemented a generous social policy, including not only the sale of food at stable prices, free pre-school and school education, and subsidized health care, but also the creation of artificial jobs as a part of large-scale state projects.<sup>63</sup>

All this aid was clearly tied up with professional trade unions (controlled by the Labor Party), the government (headed by the Labor Party), and the Jewish Agency, which for all intents and purposes continued to remain an omnipotent organization in the early 1950s, as well. Compact and easily governable population groups (Arabs and Ultra-Orthodox Jews) were provided with additional aid and support, directly selling the Knesset seats of the parties representing them to the government coalition. The rest of the population cast its votes based on its own free preferences, thus ratifying the situation in which a limited group of people assumes the responsibility for providing for all of the citizens' needs, along with the right to determine state policy on their behalf.

Subsequently, the extent of Israel's dependence on rent revenue went down steadily thanks to rapid economic growth and cuts in foreign aid. Yet institutions created for providing for the stable existence of a rentier economy function still. The political instability typical of Israel during the last 30 years is in many ways a reflection of this contradiction.

Let us note a similarity between Israel and Mexico. The regimes in both states were based on rentier state income and political institutions were supposed to maintain the source of these payments under the ruling group's control. In both states, the level of rentier dependence went down inexorably, finally ceasing to play any noticeable role in the economy. The unpreparedness and – or – the unwillingness of the authorities to adapt existing institutions to the new balance of power led to political instability in both Mexico and Israel.

Israel's population was thus initially the recipient of social goods, but not the originating source of authority. Institutions created precisely during this period of time reflect this state of affairs. The case of Israel confirms the scheme proposed by the model: the crystallization of rent revenue at the initial stage of the formation of the political institutions presupposes the minimization of democracy as social goods are provided more and more efficiently.

## **Conclusions and Further Researches**

---

<sup>62</sup> [www.etzel.org.il/ac20.htm](http://www.etzel.org.il/ac20.htm).

<sup>63</sup> Zatzovecky, Zhavoronkov, et al. 2013.

The possibility of the authorities' obtaining incomes not subject to control by society, as well as incomes not dependent on investment climate quality, gives the authorities a great deal of freedom. Given a certain level of organizing, taxpayers may try – in exchange for money – to compel the government to accept conditions of their own dictating. (History demonstrates that this can often enough be done quite successfully). The history of many modern parliaments began with the assemblies of people who relied on money and armed force to provide for the might of the state.<sup>64</sup>

The absence of a need for the authorities to ask their subjects for financial support in exchange for guarantees and privileges makes the authorities' superiority to every market agent (subject) in terms of power practically uncompensated for in any way.<sup>65</sup> But if the government's income is such as to enable it to "bribe" its citizens, the threat of uncontrollable authority will suffice to bring about the destruction of those democratic institutions which are already in existence. Given such a state of affairs, there can be no question of imposing restrictions capable of guaranteeing reliable universal safeguards for business independently of the will of the ruler.

During a period of resource plenty, the country headed by a good and generous ruler may seem a thoroughly attractive place, up until the moment of the resources' depletion. Upon running out, such resources leave behind unfit institutions and civic skills of self-rule and normal business reduced to zero level.

In certain isolated cases the ruler – provided he is a well-intentioned "stationary bandit" with well-developed common sense – may offer and sustain personal guarantees. But Olson's supposition<sup>66</sup> that guarantees of this kind are not distinguished by reliability is borne out by numerous historical instances.

The instances studied have demonstrated the rightness of the basal assumption of the model that the extent of the damage caused by a rentier economy to democracy depends on the extent of institutional development of the state at the time of its first beginning to receive rent revenue payments. In Israel and in Venezuela, institutions were in embryonic condition or just beginning to take shape, making the democracy in these states suffer an overwhelming blow. In Norway, the institutions were relatively well-developed, so that rent revenue payments did not cause great damage.

Research has shown a real influence by countries providing the rent revenue payments on the level of democracy in Israel and the USSR. It may also be of considerable interest to discuss the impact of the model's third assumption (the state as a monopolist in supplying public goods) on the level of democracy in the state.

The simple model proposed demonstrates that a genuine mutual interest obtains between voters and political leaders in reaching agreement concerning "extending" the supply of public goods for citizens in exchange for their noninvolvement in running the state. Only democratic institutions which have been previously developed and which restrict the opportunities for voluntary redistribution of influence can weaken the motivating force of this factor.

Immigrants attracted by generous social programs also tend to give up freedoms in exchange for rent revenue payments. The influx of immigrants drawn mainly by programs of this kind portends a series of problems.

---

<sup>64</sup> Meaning the state's ability to provide the public good of "defense."

<sup>65</sup> This holds provided citizens do not have at their disposal comparable military force, an unlikely situation.

<sup>66</sup> Olson 2000.

## Sources

- Anderson L.* The State in the Middle East and North Africa // *Comparative Politics*, 20. October 1987.
- Barro R.J.* Determinants of Democracy // *Journal of Political Economy*. 1999. Vol. 107. N 56.
- Beblawi H.* The Rentier State in the Arab world // Giacomo Luciani (ed.). *The Arab State*. Berkeley: University of California Press, 1990.
- Canache D., Kulisheck M.R.* Reinventing Legitimacy: Democracy and Political Change in Venezuela // Greenwood Publishing Group, 1998.
- Catzo Luis A.V.* Mexico and Export-Led Growth: the Porfirian Period Revisited // *Cambridge Journal of Economics*. 1998. Vol. 22. N 1.
- Delacroix J.* The Distributive State in the World System // *Studies in Comparative International Development*, 15 (Fall 1980).
- Desarrollo Economico. Retrieved on 2007-02-17.
- Diamond D.L., Linz J.J., Lipset S.M. (eds.)*. Democracy in Developing Countries (Boulder, Colo.: Lynne Rienner, 1988); *Inglehart R.* Modernization and Postmodernization. Princeton: Princeton University Press, 1997.
- Egorov G., Guriev S., Sonin K.* Media Freedom, Bureaucratic Incentives and the Resource Curse. University of California, Berkely. Paper WP2007'3.
- Egorov G., Guriev S., Sonin K.*, (2006) "Media Freedom, Bureaucratic Incentives, and the Resource Curse" <http://ideas.repec.org/p/cfr/cefirw/w0063.html>
- Gaidar Yegor* "Collapse of an Empire: Lessons for Modern Russia" Brookings Institution Press October 17, 2007
- Giladi D.* Economy of Israel: First Years. [www.education.gov.il](http://www.education.gov.il).
- Gylfason, Thorvaldur*, 2001. "Nature, Power, and Growth," *Scottish Journal of Political Economy*, Scottish Economic Society, vol. 48(5), pages 558-88, November
- Haber S.H., Mauer N., Razo A.* When Law Does Not Matter: The Rise and Decline of the Mexican Oil Industry // *The Journal of Economic History*. 2003. 63. 1.
- Herb M. N* Representation without Taxation? Rents, Development and Democracy. Georgia State University, December 3, 2003.
- Karl T.* The Paradoxes of Plenty: Oil Boom and Petro-States. Berkely, CA: University of California Press, 1977.
- Kosenko K.* Formation of Business Group in Israel and Their Impact on the Companies and the Economy. Discussion Paper Series 2008.02. Bank of Israel Research Department, 2008.
- Lagoven S.A.* Venezuela and the Oil Pioneers, 1993.
- Lisin V., Yanovskiy K. Et al.*, "Institucionalnye ogranichenia sovremenogo ekonomicheskogo rosta" - Institutional Constraints on Modern Economic Growth – "Delo" Publishing House Moscow, 2011 (in Russian; unedited chapters' translation in English see <http://instecontransit.org/how-to-import-modern-western-institutions-to-suppress-economic-growth-in-underdeveloped-countries/>).
- Mahdavy H.* The Pattern and Problems of Economic Development in Rentier States: The Case of Iran // *Studies in the Economic History of the Middle East* / Ed. M.A. Cook. Oxford: Oxford University Press, 1970.

- Marshal C.* The experience of Banamex: French Bankers and Banking Models in Mexico, 1884—1900. Paper prepared for Session 102 of the XIV IEHA World Congress. Helsinki, August 2006.
- Mason J.* Hart Revolutionary Mexico: The Coming and Process of the Mexican Revolution. University of California Press, 1997.
- Mau V.*, "Lessons of the Spanish Empire, or the Curse of Resource Abundance" 2012 <http://ssrn.com/abstract=2117758>
- Mau V., Zhavoronkov S., Yanovskiy K., Cherny D.* "The Deregulation of the Russian Economy" // Problems of Economic Transition, vol. 45, no. 5, September 2002, pp. 5-66. M.E. Sharpe, Inc.
- Monaldi F., González R.A. et al.* Political Institutions, Policymaking Processes, and Policy Outcomes in Venezuela // Inter-American Development Bank, Latin American Research Network, Research Network Working Paper #R-507, January 2006.
- O'Donnell G., Schmitter Ph.C., and Whitehead L. (eds.)*. Transitions from Authoritarian Rule: Prospects for Democracy. Baltimore: Johns Hopkins University Press, 1986.
- Perry G.E., Lypez J.H., Maloney WF. & et al.* (2006). Poverty Reduction and Growth: Virtuous and Vicious Cycles. Washington, DC: The International Bank for Reconstruction and Development / The World Bank.
- Poniatowska E.* Massacre in Mexico. University of Missouri Press, 1991.
- Przeworski A., Alvarez M., Cheibub J.A., Limongi F.* What Makes Democracies Endure? // Journal of Democracy 7 (January 1996); *Idem.* Democracy and Development: Political Institutions and Well-Being in the World, 1950—1990. N.Y.: Cambridge University Press, 2000.
- Przeworski A., Limongi F.* Modernization: Theories and Facts // World Politics 49. January 1997.
- Ricardo D.* On the Principles of Political Economy and Taxation. L.: John Murray, 1921.
- Rippy M.* Oil and The Mexican Revolution. Leiden, 1972.
- Ross M.L.* Does Oil Hinder Democracy? // World Politics 53 (April 2001).
- Rubio Mar.* Oil and Economic in Mexico, 1900—1930 // UPF Economics & Business Working Papers. May, 2003. N 690.
- Rubio Mar.* Towards Environmental Historical National Accounts for oil Producers: Methodological Considerations and Estimates for Venezuela and Mexico over 20th Century. PhD: London School of Economics, 2002.
- Sachs J., Warner A.* Natural Resource Abundance and Economic Growth // NBER Working Paper Series. N 5398. Cambridge MA, 1998.
- Starodubrovskaya I., Mau V.* "The Challenge of Revolution: Contemporary Russia in Historical Perspective" Oxford University Press, 2001
- Tsui K.K.* More Oil, Less Democracy?: Theory and Evidence from Crude Oil Discoveries. University of Chicago (Job Market Paper). December 29, 2005.
- V. Tambovtsev, L. Valitova,* "Resursnaya obespechennost' strany i yeyo politiko-ekonomicheskkiye posledstviya" ["Resource Plenty in a Country and Its Political-Economic Consequences"], Ekonomicheskaya politika [Economic Policy] 2007, #3 (7).
- Wiktorowicz Q.* The Limits of Democracy in the Middle East: The Case of Jordan // The Middle East Journal, 53. Autumn 1999.

*Yanovsky K., Zatsovecky I.* Sources of the Leftist's Governing Position in the Israel.  
Lecture on the Conference in Memory of «Altalena». June 2007.

*Zatsovecky, I., Zhavoronkov S., Yanovskiy* (2013) The Democracy Abridged: Factors  
in Restricting Political Competition <http://ssrn.com/abstract=2359010>

**Few Online sources for references**

US States Department. <http://www.state.gov/>.

Yale Law School . <http://www.yale.edu/>.

Electronic Encyclopedias: <http://www.diclib.com/cgi-bin/>; <http://www.eleven.co.il/>.  
<http://www.ynet.co.il/yaan/>.

Etzel underground organization memorial web-site <http://www.etzel.org.il/>.

Israel Knesset official web-site <http://knesset.gov.il/> .