Oil to Cash: Fighting the Resource Curse through Cash Transfers

Todd Moss

Abstract

Many of the world's poorest and most fragile states are joining the ranks of oil and gas producers. These countries face critical policy questions about managing and spending new revenue in a way that is beneficial to their people. At the same time, a growing number of developing countries have initiated cash transfers as a response to poverty, and these programs are showing some impressive results. In this paper, I propose putting these two trends together: countries seeking to manage new resource wealth should consider distributing income directly to citizens as cash transfers. Beyond serving as a powerful and proven policy intervention, cash transfers may also mitigate the corrosive effect natural resource revenue often has on governance.

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Introduction

The ranks of oil and gas producing countries are swelling. Historically high commodity prices are combining with technological advances to drive new oil and gas exploration in countries once considered marginal to global energy markets. These new or soon-to-be producers face critical policy decisions, such as how to spend the new income and how to take steps to avoid the dreaded so-called resource curse. Ghana joined the oil club on December 15, 2010 when its Jubilee field started operations but many of the policy questions—how to manage oil contracts, how to manage the revenues, what kind of oversight is necessary—are still unresolved. These questions are especially urgent and pertinent because many of the new producers are some of the world's poorest and most fragile states—Sierra Leone, Timor Leste, Cambodia, Papua New Guinea, Liberia. What these countries should do with their oil revenues is neither an easy, nor an obvious question. But it does have enormous consequences for the millions of poor people residing in these countries.

At the same time, and entirely separately, cash transfers have become a hugely popular response to poverty. The success of Mexico's conditional cash transfer program has led many developing countries—South Africa, Brazil, India, Indonesia, Bangladesh, Nepal, Namibia, Botswana, Colombia, Honduras, Armenia, Panama, Jamaica, and more—to launch some kind of similar intervention, as recently summarized in the new book *Just Give Money to The Poor* (Hanlon, Barrientos and Hulme 2010). In fact, the authors estimate that at least 45 countries now have cash transfers programs of one type or another, reaching a total of 110 million families. According to the advocates of cash transfers—and backed by a growing stock of rigorous evaluations of these programs—such an approach is economically efficient and can have a meaningful and measurable impact on a range of development outcomes. This, coupled with potentially strong political benefits, suggest that cash transfer programs are likely to spread further.

While their connection is not immediately obvious, this paper proposes putting these two trends together: countries seeking to manage new resource wealth should consider

distributing income directly to citizens in the form of cash transfers. Beyond serving as a powerful and proven policy intervention, cash transfers can mitigate the corrosive impact of oil on governance. This idea has been growing within the research community (Subramanian and Sala-i-Martin 2003; Birdsall and Subramanian 2004; Sandbu 2006; Moss and Young 2009; Gelb and Grassman 2009; Segal 2009; Devarajan, Le, and Raballand 2010b). More importantly, this idea is starting to take hold among policymakers. Alaska has distributed dividends from earnings on oil savings directly to state residents since 1982. More recently, Bolivia has linked its gas receipts to pension payments (a cash transfer targeted to the elderly), while Mongolia has used mining income to fund a child benefit program (a cash transfer targeted to the young).

With more countries facing difficult policy choices, most of the international community has put a premium on transparency as the way forward. However, efforts like the Extractive Industries Transparency Initiative (EITI) only shed light on one link in the long chain from oil in the ground to development outcomes. Similarly, experiences in countries like Chad to use offshore funds with special external oversight have largely failed to have the desired effect. Both of these approaches help build a supply of transparent information, but prove unsustainable or insufficient because they do not create demand in countries for such transparency or incentives to use such information to influence government actions.

One option, complimentary to EITI and the revenue ringfencing, is to distribute new natural resource income directly to citizens in a regular, universal, and transparent payment. Such an approach may bring strong economic and political benefits, and may help countries not only avoid the corrosive effects of the resource curse but also help to create demands for transparency and accountability. This paper explains the resource curse idea, the cash transfers trend, and then proposes to put them together. Subsequent sections consider the benefits of such an approach, briefly outline some of the countries where this proposal may be most relevant, and then compare the policy alternatives. The paper ends by addressing some common objections to the proposal.

The resource curse

After more than twenty years of research, the "resource curse"—the idea that a country's reliance on natural resource extraction can be detrimental to its economic, political and social wellbeing—has come to be widely accepted by political scientists, economists, journalists and policymakers (Gelb 1988; Sachs and Warner 1995; Karl 1997; Collier and Hoeffler 2000). More specifically, numerous studies have found links between dependence on natural resource exports and several different negative outcomes, including increased conflict, authoritarianism, corruption, poor macroeconomic performance, and poverty. Because these outcomes can be

mutually reinforcing—for example, poverty may cause increased likelihood of conflict, and vice versa—the resource curse can lead to downward cycles of poverty and political instability.

Researchers across various fields have measured associations between natural resource dependence or abundance and a host of poor economic and political outcomes[1]:

- *Macroeconomic instability and export concentration.* Extreme dependence on a small number of exports makes countries vulnerable to volatility of international prices, which leads to wild swings in fiscal policy and to general macroeconomic instability (Gelb 1988; Sachs and Warner 1995).
- *Poverty.* From 1960 to 1990, the economies of resource-poor countries grew two to three times faster than resource-rich countries (Auty 2001).
- *Corruption.* A 15% increase in the share of natural capital in national wealth is correlated with a 20 percentage point drop in the corruption perceptions index (Gylfason 2001).
- *Authoritarianism.* Diamond (2008) reports that all of the 23 countries most dependent on oil and gas were under authoritarian rule at some point between 1974 and 2008, while Ross (2001) finds that the presence of both oil and minerals is significantly correlated with autocracy.
- *Conflict.* When primary commodity exports make up 33% of a country's GDP, the likelihood of conflict increases to 22% compared to 1% for a country with no such exports (Collier and Hoeffler 2000).

What may account for these associations? Although most models recognize that the resource curse probably operates through a variety of mechanisms, there is a general split in the literature between those who find an economic explanation (through the Dutch disease effect), and those who propose that natural resources have a corrosive effect on key political institutions (a social contract effect). While these effects are not mutually exclusive, much of the past research has either focused on, or sought to establish the relative importance of, one of these mechanisms.

[1] For a more complete review of the literature, please refer to Moss and Young (2009). A new round of research has cast a skeptical eye on the resource curse by using panel data and investigating reverse causality, e.g., the possibility that poor institutions may cause natural resource dependence, as well as the other way around (Brunnschweiler and Bulte 2008; Wacziarg 2009; Haber and Menaldo 2010; Martin 2010). However, while this new literature places strong emphasis on the importance of institutional quality in shaping the net impact of natural resources, the idea that in institutionally-poor settings oil rents can be detrimental, and divorce the state from public accountability, remains generally accepted.

The earliest models of the effect of resources on growth focused on their negative macroeconomic effects. The most well-known of these effects is known as the "Dutch disease" and refers to the tendency of natural resources to crowd out other exports through their effect on exchange rates. The economic principle behind the Dutch disease is straightforward: a surge in natural resource exports in a particular country drives up its real exchange rate, which makes other exports relatively more expensive (Corden and Neary 1982; Corden 1984; Neary and van Wijnbergen 1986). This negative impact on other exports is compounded by the exchange rate volatility caused by frequent swings in natural resource prices (Gylfason, Herbertsson, and Zoega 1999; Herbertsson, Skuladottir, and Zoega 1999).

To add insult to injury, government attempts to protect themselves from the Dutch disease may prove as harmful as the disease itself. Sachs and Warner suggest that the largest indirect effect of natural resource dependence on growth was caused by protectionist policies put in place by governments trying to stop the atrophy of their other non-commodity exports (1995). Together, these effects prove harmful to resource-dependent economies, possibly accounting for the relationship between natural resources, lower rates of growth, and sustained levels of poverty.

The other major causal channel that could explain the negative development outcomes in resource-rich countries emphasizes not resources' effects on prices, but their corrosive impact on political institutions. In particular, natural resources undermine a government's reliance on its citizens for tax revenues and ultimately sever, or at least strongly impair, the social contract between them.

Taxes, social contract theory tells us, are the foundation of accountability between the state and its citizens (Bräutigam 2008). This idea traces its roots to the development of democratic institutions in England and France, where cash-strapped governments had to bargain with taxpayers in order to raise the revenue to finance expensive wars (Tilly 1985; North and Weingast 1989). In exchange for taxes, citizens demanded public services, rights and greater voice in government actions (Bates and Lien 1985).

"Unearned income," like oil revenue, that requires no effort on the part of the government, can disrupt the establishment of a social contract, especially in young nations still in the process of building capable states. In essence, resource rents poured directly into state coffers reduce the state's need to levy taxes to raise revenue for public spending. Without this need to raise funds from their citizens, governments are released from their duty to be responsive to their needs. This can create (or reinforce) "rentier states" that are dependent on a narrow economic base (such as a small group of foreign oil companies) but not accountable to their citizens.

Conversely, stripped of the power of the purse, citizens are unable to exert leverage on the government for public service provision and responsible management. In other words: "Without taxation, no representation."

The implications of the breakdown of the social contract are far-reaching, as unaccountable states seem to invest less in the development of their citizens (Gylfason 2001), and have less efficient public spending (Robinson, Torvik, and Verdier 2006), weaker accountability mechanisms (Devarajan, Le, and Raballand 2010), and greater levels of corruption (Vicente 2009).

In sum, major oil discoveries are a lot like winning the lottery: the announcement is typically greeted with great joy, but the eventual outcomes on recipients are often worrying. This suggests that policymakers concerned about the resource curse should be aggressive in finding ways to mitigate or circumvent its most pernicious effects.

Cash transfers

Cash transfers are increasingly popular both within the donor community and among policymakers in developing countries seeking more innovative ways to raise welfare. Among donors seeking to more directly reduce poverty and provide social protection for the most vulnerable, distributing cash may be more efficient than public sector spending in many developing countries (Standing 2008; Morley and Coady 2003). Middle-income countries have also innovated with very large conditional cash transfer (CCT) schemes to provide cash targeted to the poor and to encourage certain behaviors. The most prominent CCTs are Mexico's *Progresa-Oportunidades* and Brazil's *Bolsa Familia*. Mexico's scheme covers approximately one-quarter of the population and provides cash payments to low-income families in exchange for regular school attendance, health clinic visits, and nutritional support. Brazil's plan is the world's largest conditional cash transfer and provides 12 million families with monthly stipends if children regularly attend school and are vaccinated.

Part of the popularity of the CCTs has been the rigorous evaluations of the programs, which have tended to show strong effects. For instance, children participating in Oportunidades had 12% lower incidence of illness, were 33% more likely to be enrolled in school, and 23% more likely to finish grade 9 than children outside the program (Hanlon, Barrientos and Hulme 2010). Interestingly, some recent evaluations have attempted to separate the effects of the cash from the effects of the conditionality. They generally suggest that the main impact comes, not from the condition, but from the money. Brazil's unconditional rural pension, for instance, increased school registration of children, while the unconditional pension in South Africa cut non-

attendance in half (Hanlon, Barrientos, and Hulme 2010, 57). A World Bank study of cash transfers in Malawi concluded that the determining factor for increases in school enrollment was the increase in income, not the conditionality, which had no discernable impact (Baird, McIntosh, Ozler 2009). Thus, the conditions attached to such programs, and the additional cost of enforcing them, may be less valuable than the cash itself. [2]

Different variations of cash transfers exist. They may be either conditional or unconditional, large or small, and universal or targeted at certain demographic, economic, or geographic populations. A very common unconditional yet demographically targeted cash transfer that exists is a pension. These are typically regular payments to a segment of the population (the elderly) but are not dependent on any behavior (although the level may be linked to prior contributions). Another common type of demographically targeted cash transfer is the child benefit, a simple flat payment made to families for each child, usually capped at a certain number. Child benefits can be further targeted only to the poor (e.g., Mongolia's Child Money Program or South Africa's Child Support Grant) or be universal (e.g., Britain's Child Benefit). Yet another form of cash transfer has been the income payments to Native Americans from gaming profits, which is universal for all adult tribal members of the individual tribe (Akee et al. 2008).

Perhaps the most interesting case is that of Alaska's Permanent Fund. The Fund was set up in the mid1970s almost immediately after oil was discovered to create an investment base to produce revenue even as future oil production decreased. In 1982 the government instituted the Permanent Fund Dividend (PFD) program, a regular cash transfer of the Fund's interest earnings to state residents (Fasano 2000). Championed by then-governor Jay Hammond, the PFD was created explicitly to give Alaskans a stake in protecting the oil revenues and the integrity of the Fund, and ultimately to limit wasteful state spending. In the governor's words:

> Rather than permitting government to spend all public monies earned through exploitation of the public's resources for what government thinks best, let's grant shares to Alaskans and let them determine what services they want enough to permit government to recoup those shares in taxes. Nothing could do more to curb excessive growth of government…(cited in Harmon 1977)

In recent years Alaskan households have been receiving 3-6% of their average income from the PFD and it is now a regularly anticipated component of household income. The dividend has

[2] The benefits of conditionality might however be rather political than economic. Adding demands that the poor "do something" (like send their children to school or have them vaccinated) might be necessary in helping make cash transfers politically acceptable, even while having little to do with its eventual success (Morley and Coady 2003).

been "extremely successful in creating a political constituency for the Permanent Fund that did not previously exist" and most politicians consider it "political suicide to suggest any policy change that could possibly have any adverse impact today, or in the future, on the size of the PFD" (Goldsmith 2002).

More recently, Mongolia and Bolivia have attempted to use part of the Alaska model by linking their own natural resource revenues (mining and gas, respectively) to finance cash transfer programs. Copper and gold receipts fund Mongolia's Child Money Program, while Bolivia's earnings from exported natural gas go into the pension system.[3]

If you love something, let it free: A proposal

We propose putting these two trends—a greater understanding of the resource curse and growing innovation with cash transfers—together in a new model for natural resource management in resource-rich, poorly-governed states: give the revenues to citizens in a regular, universal, and unconditional cash transfer.[4] Rather than put the funds into the budget (and hope that they trickle down to the people) or into a savings fund (and hope they are used wisely in the future), this would put the cash directly into the hands of the people.

The rationale for doing this includes both economic and political benefits:

1. Incentives to tax. After giving cash to its citizens, the state would treat it like normal income and tax it accordingly—thus forcing the state to collect tax revenues and build tax administration, rather than simply bypassing the taxpayers by relying solely on rents. Although this initially sounds like an unnecessary step (why give something away that you are going to partly take back?), creating incentives for tax collection and administration is perhaps the most important potential benefit of this scheme (Devarajan, Le, and Raballand 2010). Because the government must tax the oil revenue to recover some of it for public spending, the social contract is strengthened rather than broken by natural resource revenues.[5] Governments will

[3] See forthcoming case studies from Revenue Watch Institute on Bolivia by Roberto Laserna and Mongolia by Chuluunbaatar Enkhzaya and Alexandra Gillies.

[4] The terms "cash transfers" and "direct distribution" are both used in the literature and are used here interchangeably. For the remainder of this paper, "cash transfers" will be used to denote unconditional cash transfers, unless otherwise noted.

[5] See Devarajan, Le, and Raballand (2010) on the positive empirical relationship between taxation and measures of budget accountability and public sector efficiency. Aid dollars, abundant in many of these developing countries, ironically may also have similar governance effects to oil, allowing public officials to live off grant money and severing the state's need to serve its constituents (Moss, Pettersson, and van de Walle 2006).

be forced to depend on the citizens for income, and consequently, citizens will have increased leverage and incentives to exert pressure on public policy.

2. Incentives for accountability*.* Cash transfers from natural resource revenues would give citizens strong incentives to carefully monitor the incoming revenue, management of the resources, and how it is distributed. Because citizens would now have a direct personal stake in the resource, cash transfers would likely create an intense constituency for responsible management and demands for accountability. It is one thing to stand by quietly as oil reserves are mismanaged when the oil rents are kept in an offshore bank account or are distributed as patronage to a select few. It is quite another thing when the mismanagement of those oil fields threatens a direct source of income. This was the primary purpose of the Alaska plan: to limit government waste by creating greater incentives for citizens to hold their governments accountable (Fasano 2000).

3. Good for national equity. Cash transfers would likely be more equitable and pro-poor compared to current spending patterns in most developing countries. In most poor countries, government spending is concentrated in relatively richer urban areas, and typically shows significant regional disparities. A uniform and universal cash payment would instead allocate equally to every citizen (ideally, including children). This would be an immediate benefit for people living in underserved areas, including those from marginal groups.

4. Good for the poor. Importantly, cash transfers would have immediate and significant economic benefits for poor households—and ultimately for development. Even a small amount of extra regular income can make a huge difference to the world's poorest by enabling increased investment in nutrition, health, education and even microenterprise (Case 2001; Yanez-Pagans 2008). Providing some income security, even if the payments are modest, would allow poor households to avoid negative coping mechanisms like asset stripping. Indeed, it is hard to imagine any public services that would deliver an immediate income benefit of, say 10%, to the poor *other* than cash transfers.

The pipeline of new countries at risk

What makes countries most vulnerable to the resource curse? Low-income countries with poor initial institutional quality and governance seem more susceptible to the resource curse than countries that discover oil after they are already wealthy, consolidated states. This seems logical: Nigeria found oil in the years immediately after independence and proved to be more vulnerable to the curse than Norway, which had been a constitutional democracy for at least 150 years before discovering oil. Much of the potential resources in low-income countries have

not yet been discovered, let alone exploited (Collier 2010). However, as older oil and gas fields become depleted and prices for these commodities remain high, exploration has been accelerating in new countries. In fact, a number of low-income countries with relatively weak governance have recently discovered commercially-exploitable reserves of oil or liquefied natural gas (LNG) (Table 1).

Table 1: The new oil & gas exporters (And potential cash distribution candidates?)

Country	**Resource**	**Discovery year**	**Expected extraction**	**Potential quantity**	**GDP/cap** (2008 US$)
Cambodia	Oil & LNG	2006	2011	Oil: 400-700 million barrels (bbl); LNG: 3-5 trillion cubic feet (TCF)	711
Ghana	Oil	2007	2011	600 million - 1.8 billion bbl	713
Papua New Guinea	LNG	1986	2013-14	9 TCF	1253
Sierra Leone	Oil	2009	TBD	>45 net feet of hydrocarbon pay from Venus block	352
South Sudan	Oil	1978	2011 (possible independence)	5 billion bbl – 75% of which are in the south	n/a
Timor Leste	LNG	2000	2013-2018	5.13 TCF & 225.9 million barrels of condensate	453
Uganda	Oil	2006	2011	1.2 billion bbl commercially viable	453

These new discoveries are potentially devastating because these countries are particularly susceptible to the pernicious effects of resource rents on their economies and on their political institutions. At the same time, the expected income flows provide an opportunity to implement preemptive policies—such as a direct cash transfer scheme—to protect the state from the resource curse. The dynamics of vested interests suggests that the likelihood of attempting a distribution scheme as proposed here may be higher if designed and implemented before the income arrives and influential political groups have coalesced around resource rents (See Gillies 2010). Efforts to curtail the impact of the natural resource curse should therefore focus on these countries.

Alternative policy proposals to cash transfers

The efficacy of distributing natural resource income directly to citizens depends on weighing this approach relative to the other options available to policymakers. These alternatives are, broadly speaking, to spend it or save it.

Spend it now through the budget (increase public expenditure)

If low-income countries are (almost by definition) cash-strapped and lack basic public infrastructure, why not simply allow the government to use resource rents directly to invest in better public services and infrastructure? Why would a government that needs more funds to build schools, hospitals, roads, and power plants just hand the money over to citizens? Aren't these the investments necessary for long-term growth?

In theory, spending new revenues on public goods is a wise choice. However, the mere existence of a need does not necessarily mean that the best use of new funds is to fill that deficiency. The efficiency of systems to turn funds into the desired outcomes is highly relevant, and in this case potentially very worrying. Growing evidence points to high levels of "leakage" and extremely low levels of service delivery for the supposed beneficiaries in many of countries that are facing this policy choice. Some two dozen public expenditure tracking surveys (PETS) have been conducted in developing countries, mostly in Sub-Saharan Africa (Gauthier 2006). The first of these, a 1996 study in Uganda, showed that 87% of non-wage education spending was lost before reaching the schools for which it was destined (Ablo and Reinikka 1998). In Chad a similar study conducted before the country began exporting oil found only 1% of non-wage health expenditures to regional health administrations arrived at the health facility level. In Ghana, which is often considered to have one of the better performing public sectors, surveys found leakage rates of 50% in education and 80% in health (Gauthier 2006).

Similarly, the reality of serious shortages of quality infrastructure in Africa does not automatically suggest that new revenues are necessarily best spent filling that gap. Project selection has historically been a major problem in low-income countries (roads to the President's village rather than to the port) while large-scale construction has been among the sectors most susceptible to corruption (Kenny 2007).

This poor record suggests neither that all public spending is wasteful nor that countries cannot improve on their current performance.[6] Clearly, all governments invest in public services and

[6] Indeed, in a much-publicized case, a follow up survey in Uganda found that after school budget allocations were posted on the door of schools that the leakage rate dropped to "only" 18% (Gauthier 2006).

all can (and should) work hard to improve efficiency. However, in the case of countries where it is already very clear that public expenditure is problematic, an injection of major new funds should be weighed against other options based on the likely impact and use of those funds in practice, not with the mere hope that such funds could be theoretically used well if the system improves. Indeed, efforts to reform dysfunctional public services are in some cases likely to be hampered by increased cash flows.

Perhaps more importantly, direct investment of new resource revenues into the budget does nothing to address the effect of oil on political institutions and the social contract. Thus, low public sector productivity is likely to worsen as the state becomes even more divorced from the population and public accountability. Moreover, as resource rents increase, so too may the incentives for civil servants and politicians to engage in patronage, rent-seeking, and corruption (Gelb 1988; Karl 1997).

Save it for later (create a special savings fund)

One of the alternatives most often proposed to deal with natural resource revenues is to place them in a stabilization fund or a future generations fund. A stabilization fund is designed to smooth public expenditures by protecting government income from short and medium term fluctuations in the price of oil (Bell, Heller and Heuty 2010). A future generations fund simply saves the funds for later, either to try to provide intergenerational equity or to use funds for after the (nonrenewable) resource has been depleted. In most cases, these funds are held offshore, both for economic (to limit the currency or Dutch disease effects) and governance (to enable professional fund management and limit political interference) reasons.

Norway, for example, is a wealthy oil-producing country with an aging population. So it established a sovereign wealth fund with a view to fund its pension system. Russia, on the other hand, facing a different set of constraints established a stabilization fund primarily to mitigate the fiscal shocks due to fluctuations in oil price. Other countries, like Chile and Ghana, have adopted or are in the process of creating, both types of funds.

While setting aside oil revenue in a fund for careful and future spending may make sense, in practice the success still depends on political arrangements. Creating a savings fund in and of itself does not change the underlying political economy of the state. The government is still sheltered from political accountability by its access to resource rents (Humphreys and Sandbu 2007) and can change the rules about use of savings funds. Without a politically salient

constituency with a vested interest in protecting the savings funds, governments can simply raid them.[7]

The most infamous example is Chad, where the World Bank loan for the pipeline to enable oil exports was conditioned on funds being put in a special fund, with the vast majority designated for development programs.[8] As soon as the Bank had financed the pipeline, Chad paid back its loans and the parliament rescinded the law to allow revenues to be spent on other national priorities such as the military and presidential expenses. There was no influential Chadian constituency for sound management, and thus no political backlash against the government for simply reneging on the deal and doing what it pleased. Nigeria has also established numerous spending and savings rules for its oil revenues, but has rarely adhered to them for long (Eifert, Gelb, and Tallroth 2002; Ross 2003; Ahmad and Singh 2003).

Thus special offshore savings accounts may be a good idea for meeting certain objectives. They may make sense as a mechanism to promote transparency and to ringfence oil revenues (before transferring them to into the budget, an infrastructure fund, a savings or sovereign wealth fund, or a cash transfers facility). But the experience of many countries suggests that the mere presence of a fund does not fundamentally alter the choices of policymakers.

It is also worth pointing out that these three broad options for using oil windfalls—spending, saving, and giving it away—are not mutually exclusive. Policymakers of course have the option of allocating revenue across these three alternatives. In other words, implementing a cash transfer system does not have to imply using 100% of revenues. For reasons outlined below, it may also be desirable to have very clear allocation and budget rules that are enshrined in the constitution (via amendment of, likely even better, a national referendum). These provisions may be helpful in constraining future governments that might seek to later alter the arrangement.

That can't work in my country: Some common objections

There are many reasons to think that a universal cash transfer scheme might not be appropriate or have the desired effect. In addition to claims that the funds would be better spent or saved which are dealt with above, some of the common questions include:

[7] If the main objective is to save for the future and prevent asset stripping, then the best option may be to simply leave the oil or gas in the ground by restricting production.

[8] The agreement stipulated that 80% of oil revenues would go for direct development and poverty reduction expenditures, 10% set aside in a future generations fund, 5% for the oil-producing region, and the remaining 5% for discretionary spending (Republic of Chad & IBRD 2001).

Logistics: How can we implement a cash transfer system to all citizens when we have no national identification and so few people have bank accounts?

Transferring funds to the entire population of a poor country may seem daunting, yet it is already being done. Developing and emerging-market governments make regular payments to some 170 million people as of 2009, and more than 60 countries have some form of social transfer system (Pickens, Porteous, and Rotman 2009).[9] New technology for identification and money transfers make such cash payments both feasible and potentially very low-cost.

Any payment system needs to accomplish two functions: verification of identity and transfer of funds. In the past, government-to-person payments such as pensions and social transfers have largely been done using in-person handouts of physical cash at great cost and with significant leakage. Today, even in the poorest countries, electronic payment and transfer systems are gaining popularity. Perhaps the most well-known such system is M-PESA in Kenya, which currently serves 11.9 million customers (corresponding to 54% of Kenya's adult population) and transfers approximately $415 million USD each month in person to person transactions (Mas and Radcliffe 2010). Already, about half of social transfer programs launched over the past decade feature some type of electronic payment.

Electronic delivery also slashes the administrative costs of a transfer. When Brazil's Bolsa Familia switched to electronic benefit cards, administrative costs dropped from 14.7% of the grant value to 2.6%. In South Africa the cost of transfers dropped by 62% after switching to bank accounts offered by the private sector (Pickens, Porteous, and Rotman 2009).

Electronic payment systems may also reduce inefficiencies that may arise due to fraud or corruption. Unique identifiers like personal identification numbers or new biometric data technologies—such as fingerprinting and retina scans—are increasingly available (Gelb, forthcoming). Recipients could also receive payments directly on an instrument that is within their control, such as a debit card or a mobile phone. Even where the banking system may not provide universal coverage, the mobile pre-paid card vendor network usually does.[10]

[9] The CGAP estimate is based on their own calculations for developing and emerging market countries. The authors first count the number of beneficiaries of conditional and unconditional CTs (125 million in 33 countries). They then add public sector employees and retirees, estimating that about 10% are low-income.

[10] Using the cash transfer system to provide all citizens with IDs, bank accounts, and mobile phones could also have other positive effects, such as providing ID for health insurance or voting, expended access to financial services, and benefits of new communications, including better market information and even literacy (Bankable Frontier Associates 2008; Aker and Mbiti 2010; Aker, Ksoll and Lybbert 2010).

While no system will be watertight against fraud, it is also worth remembering the counterfactual of other options. In the case of Ghana, the funds lost though public sector spending were 50-80%. By comparison, *one million* fraudulent recipients (such as ghost recipients or non-citizens illegally claiming a transfer) would be the equivalent of about a 4% leakage.[11]

Inflation: Won't cash transfers simply drive prices up?

Another argument is that cash transfers will cause inflation that could dull or even cancel out the welfare gains of the transfers. This seems potentially true if the demand for consumer goods rises as a result of the cash transfer and there is no concomitant rise in supply (perhaps due to trade barriers or low local production capacity). Yet this critique hinges on what alternative policy options the government is considering. Saving revenue in a special fund would of course have no inflationary impact as long as the funds are held offshore. However, the primary counterfactual is that the funds will be allocated toward increased government expenditure. In this case, there is little reason to believe that private individual spending will be more inflationary than public sector spending. To the extent that transfers might in fact prove inflationary, this could be addressed through a combination of monetary policy (as would be necessary in any case because of the inflow of foreign capital) and specific policy changes (especially reducing import barriers). If inflation is the primary concern, however, the tradeoff is not between public and private consumption, but rather between spending and saving.

Paternalism: Cash transfers are wasted on the poor since they don't know what's good for them

Ordinary people, it is sometimes argued, will waste the resources on frivolous consumption. There are definitional, moral, and empirical reasons that this objection does not hold up to scrutiny. First, what is often considered by economists to be "consumption" (as opposed to "investment") may be exactly the kind of welfare-enhancing outcomes hoped for by policymakers. Enhanced consumption for the majority of those living near or below the poverty line means improved nutrition and living standards. Thus for the poor, greater spending on food, housing, and other day-to-day expenses is not really consumption but rather could be considered investments in future human capital.

Second, there are principled reasons to believe that people—no matter how poor or rural or uneducated—know what is in their own best interests better than bureaucrats in faraway

[11] In terms of economic impact, any money spent in Ghana should have the same effect regardless of the nationality or identity of the recipient.

capitals. Development, after all, is in essence about freeing people from the constraints of poverty, not dictating how they should lead their lives (Sen 1999). By providing a regular, assured income, a cash transfer scheme can do precisely that—allow the poorest the freedom to make the decisions that maximize their own welfare.

Finally, the available evidence suggests that allowing people to choose how to spend their own money has efficiency gains as well. Contrary to popular beliefs that the poor do not use their money wisely, studies suggest that cash transfers tend to lead to increased spending on health, nutrition, sanitation, and education (Case 2001; Yanez-Pagans 2008). There is strong evidence of significant positive relationships between pension receipt and improved health outcomes for both children and adults living in the households of pensioners (Case 2001; Duflo 2003). Similarly positive results are recorded for education outcomes, such as enrollment and attendance, for some members of households receiving cash transfers (Edmonds 2006; de Carvalho Filho 2008; Akee et al. 2008; Baird, McIntosh, and Ozler 2010).

Labor disincentives: If people get free income then why would they work?

Cash transfers could in theory also have a negative effect on labor supply. While the evidence in this respect is mixed, some studies suggest that the traditional labor-reducing income effect may be mitigated for extremely poor households (Barrientos and Scott 2008). At the same time, numerous studies suggest that transfers enable less productive members of households to remain in the home, thereby freeing up more productive members to migrate to find better economic opportunities (Edmonds, Mammen, and Miller 2005; Posel, Fairburn, and Lund 2006; Ardington, Case, and Hosegood 2009). Others have found that a regular cash income enable children to leave the work force and attend school (Edmonds 2006).

If there are significant concerns about the potential effect of cash transfers on willingness to work, this can also be mitigated through program design. For instance, since future oil revenues may be unknown and unexpectedly high transfers may be distorting, the amounts could be capped at a ratio of average national income – for instance, a fiscal rule could limit annual transfers at no more than, say, 10% of average per capita income.

Political viability: What politician would ever give up control of oil money?

One could very well argue that direct cash distribution is quite simply not politically feasible. Getting political consensus to move to cash transfers might prove impossible since politicians have no incentive to give up access to oil wealth, which they may use to build political support or patronage networks. Implementing this proposal will certainly require political foresight and

a level of confidence that may be unusual. However, a number of countries are already doing this, so clearly politicians in Mongolia, Bolivia, and elsewhere saw some political calculation that made this attractive. The main question is what might convince politicians elsewhere to try it? Countries that have not yet received oil income may be good candidates since the barriers from entrenched interests are presumably lower (Gillies 2010). It may also be the case that once the proposal is publicly floated and begins to receive some vocal support—either as part of an election campaign or perhaps as part of a debate over a new oil law or constitutional provision—resistance may become politically dangerous, as happened in Alaska. Politicians may recognize that promoting a proposal to put cash in the hands of their constituents will become quickly and deeply popular. In countries where no prominent politician seizes on the idea, this critique is correct and implementation is highly unlikely.

Conclusion

The arrival of new unearned income should be a cause for celebration in poor countries. However, the experience of many countries suggests that such inflows can also be—and in fact often are—economically and politically destabilizing. At the same time, growing evidence suggests that cash transfers are a powerful new tool for reducing the worst effects of poverty and achieving specific development outcomes. Policymakers facing critical decisions about how to spend new income could learn from both the struggle of many countries in managing natural resource revenues, and the widespread success of others in using cash transfers. The discovery of new resource income may be an ideal opportunity to ramp up cash transfer programs while at the same time cash transfers may be one way to avoid the worst effects of the resource curse and help to build the incentives and institutions for transparent and accountable states. Going as far as distributing resource windfalls to citizens may sound radical. But given the serious economic and political risks facing the new oil and gas producers, inaction is the riskier option.

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