Panacea or Pretence? The role of private governance in alleviating Zambia's resource curse

Ainsley Elbra
University of Sydney

ABSTRACT
While the pervasiveness of the resource curse continues to be debated, for most of sub-Saharan Africa the paradox of plenty remains - the continent is rich in minerals yet many states have struggled to achieve consistent economic growth and development outcomes. The existing literature is state-centric, failing to acknowledge the role of international extractive firms in the perpetuation of this paradox. The role of private governance in developing states has not been thoroughly examined. Proponents of institutions such as the EITI argue that private governance brings added transparency and accountability, aimed at alleviating the problems associated with the resource curse. Instead, this paper shows that in the case of Zambia the private authority of firms, relative to the state, has led to the government's inability to raise taxes or implement sufficient monitoring and auditing functions thereby worsening the outcomes associated with the resource curse. Zambia's membership of the EITI, at the recommendation of Western donors and the World Bank, is aimed at rectifying this imbalance of power. However, it is argued that membership of the EITI is unlikely to curb the private authority of mining firms and may actually enhance their power by strengthening their legitimacy.

Introduction

While large mineral reserves have assisted states such as Australia and Canada in achieving first world status, strong economic growth and global power, many mineral rich developing states are yet to see the same results. Sub-Saharan Africa is a region rich in mineral and oil reserves, yet remains entrenched in poverty. Scholars label this paradox the resource curse, a term which has resulted in a large body of literature seeking to define the causes and solutions to the problem. This literature, however, is largely state focused, seeking to lay the blame for the resource curse on governments said to misuse mineral rents. This approach fails to adequately acknowledge the role that extractive firms play in continuing this paradox, and the part private governance can play in alleviating or exacerbating the resource curse.

The literature on the private authority of firms is useful in examining the role of international mining firms operating in the developing world. In particular, analysis of the private governance mechanisms that firms participate in provides explanations for the continuation of the resource curse. The emerging scholarship on private authority and its application to the extractive sectors of developing states highlights a new research agenda for the puzzle of the resource curse. Applying this framework to the copper mining industry of Zambia, it can be seen that the private authority of firms and private governance regimes have served to further entrench the outcomes more commonly associated with the resource curse, in particular they have failed to enhance the institutions of the state, thus denying the government the ability to effectively tax miners operating within the country.

The Contested Resource Curse Literature

Sub-Saharan Africa is known to possess vast amounts of natural resources, including 42% of the world's bauxite, 38% of its uranium, 42% of the world's gold and 73% of its platinum as well as 88% of the world's diamonds and significant oil and gas reserves. Yet the region remains plagued by poor economic performance and underdevelopment (Bush, 2008). While developed states have seen mineral wealth translated into consistent economic growth, social welfare safety nets and global power the states of sub-Saharan Africa have all too often seen quiescent development measures, poor economic growth and worsening income inequality. For example the rate of infant mortality in Sierra Leone remains at 114 deaths per 1,000 births, a figure of over 10% of total births (World Bank, 2012). In the Democratic Republic of the Congo a mere 34% of adults are literate and the government allocates an average of USD$16 per person to health expenditure (World Bank, 2012). While 64% of Zambians live below the poverty line (United Nations Development Bank, 2012).

The term resource curse was coined by Richard Auty in his 1993 work *Sustaining development in mineral economies: the resource curse thesis*. Since the publication of this work an immense body of literature has emerged examining the causes and potential solutions to the resource curse. Foremost of these studies is that conducted by Sachs and Warner (1995), whose empirical study of ninety-seven countries over nineteen years showed a causal link between minerals and depressed economic growth. Natural resources have been linked to increased corruption (Leite & Weidmann, 1999), the over-distribution of windfall gains (Lane & Tornell, 1995; 1999) and the normalisation of civil war (Collier & Hoeffler, 1998, 2000, 2004) – all of which are responsible for depressed economic growth.

The term 'Dutch Disease' was originally used to describe the impacts of North Sea oil on the Dutch economy in the 1970s, however it is now more commonly ascribed to resource booms in developing states. Dutch Disease refers to an influx of hard currency, which leads to a depreciation of the local currency and renders the country's export sector uncompetitive, making locally produced goods expensive relative to imports (Sachs & Warner, 1995). In addition Dutch Disease refers to the process by which capital and labour are attracted to the booming mining sector due to the ability to attract higher returns, thus disadvantaging local manufacturing and agriculture. The ability for mining to divert labour from traditional sectors reduces positive externalities such as 'learning by doing' effects that are particularly prevalent where formal schooling is limited and on the job training provides important literacy and numeracy skills.

The second economic driver of the resource curse is the impact of volatility on developing states. Stemming from fluctuations in global commodity prices, the timing of extraction and of payments, volatility has been shown to be extremely damaging to developing states, undermining existing institutions, hampering planning and boosting debt and defecits (Shaxson, 2005).

While economic factors as noted above are important determinants of the resource curse, the bulk of the political science literature on the subject highlights the detrimental impact of mineral rents on developing economies through the creation of rentier states. Rents are defined as "revenues in excess of production costs and a normal return on capital", the excess receipt of which leads to myopic policy decisions, heightened levels of corruption and weak linkages between the state and its citizens (Auty, 1993, p. 3).

Developing states, rich in resource wealth, are often subject to rent seeking by state elites. This behaviour not only diverts income from the state but leads to systemic corruption and patronage networks (Lane & Tornell, 1995). Mineral rents are often directed towards these networks or to spending on controversial or wasteful projects, and have been used to unfairly advantage incumbent candidates through diversion to campaign finances and to fund illegal militias (Ascher, 1999; Humphreys, Sachs, & Stiglitz, 2007).

States with significant mineral wealth are not forced to rely on citizens for income, leading to weak linkages between the two. Citizens who are not taxed lack sufficient avenues of recourse through a lack of bureaucratic institutions, and may even be subject to violence at the hands of a repressive state (Wick & Bulte, 2009).

The ability for states to disconnect from their citizens is highlighted in cases where resources are extracted from enclaves. Enclave economies are detrimental to the remainder of the state as they often fail to create jobs and divert state resources to specific, mineral rich areas, at the expense of the remainder of the economy. In addition to the lack of labour force growth, much of the infrastructure that is built and employed for mining is site specific, leading to suggestions that mining does little to contribute to the overall economy in developing states. Le Billon (2001) suggests that control over mines does not equate to control over the remainder of the state and that mining companies who operate in conflict zones may be supporting the suppression of citizens elsewhere in the state.

The final contributor to the resource curse outlined in the literature is the link between resources and the normalisation of civil war. The normalisation of civil war is a highly detrimental by-product of natural resource wealth, inhibiting governments' ability to provide basic services, health and education to its citizens. Empirical studies conducted by Collier and Hoeffler (2000) posit that the existence of resources significantly increases the chances of civil war taking place. After controlling for economic performance they find that the opportunities that minerals provide, including extortion, make rebellions feasible and even attractive (2000). Humphreys supports this argument, concluding that civil war is more likely in oil-rich states. He suggests that a major contribution to this conclusion is the fact that resource rich states spend between 2 and 10 times more on their militaries, even in the absence of civil war (2005).

In addition to the factors discussed above, institutional weakness contributes significantly to the resource curse. Developing states, rich in natural resources, often lack institutional strength – a facilitator of corruption by state elites, a method by which citizens are disconnected from the state and a barrier to government transparency and accountability. It has been suggested that in cases where mineral rents abound, leaders may be myopic and hesitant to alter the status quo by developing strong institutions (Anderson, 1987, p. 10; Karl, 1997, p. 101). Where elites benefit from the existing lack of transparency and accountability they will be less likely to strengthen state institutions and may even weaken existing institutions if it is perceived that they threaten their ability to capture rents (Auty, 2001; Ross, 2001).

Institutional strength is the critical junction between natural resource wealth and poor economic performance (Luong & Weinthal, 2006). Developing states have failed to build strong institutions as they are subject to the legacy effects of colonial rule, which in most sub-Saharan African cases ended as recently as the 1960s. Colonial states were often ruled as either 'dual economies', where a modern export-oriented economy operated parallel to the traditional subsistence economy, or as 'gate-keeper states' whereby colonial rulers could not, or were not, interested in controlling the social and cultural facets of their colonies and instead only managed the interaction between the state and global community (Cooper, 2002; Palmer & Parsons, 1977). The colonisation of Africa halted endogenous institutional reform as well as economic modernisation, which combined with the models used to govern colonies, left Africa with a more complex institutional legacy at independence than existed upon colonisation (Acemoglu & Robinson, 2010, p. 23).

As can be seen from the arguments above, proponents of the existence of the resource curse present a compelling case that is supported by much of the anecdotal evidence from the continent. However, the resource curse literature remains a contested space with several scholars, including some original proponents of the resource curse, arguing that the paradox is not deterministic and instead is reinforced through policy choices, constrained by path dependency (Auty, 1994; Gelb & Grasmann, 2009). Others have suggested that underdevelopment in resource rich states stems from factors other than the existence of mineral wealth (see Ahammad & Clements, 1999; Clements & Johnson, 2000; Davis & Cordano, 2008). These scholars argue that the outcomes seen in mineral rich economies are case specific, that minerals cannot be inextricably linked to rent seeking and that economic performance is a culmination of a number of factors with mining not able to be isolated (Pedro, 2006).

Sala-i-Martin and Subramanian (2003) question the relevance of Dutch Disease to developing states. They argue that Nigeria's poor long-run economic performance is attributable to waste and corruption rather than Dutch Disease. Additionally, they assert that Dutch Disease holds only in conditions of full employment. Developing states are more likely to experience labour surpluses, as reflected in Zambia's unemployment rate of 14%, which Sala-i-Martin and Subramanian suggest can be diverted to a booming mining sector without affecting traditional sectors of the economy (Central Intelligence Agency).

Karl (1997) suggests that it is the decisions governments make following oil booms that are key to determining whether a state suffers from the resource curse. She notes that while "governments rarely exercise their influence wisely", theories incorporating Dutch Disease have failed to explain why (Karl, 1997, p. 6). Rosser (2006) supports this assertion, suggesting that Dutch Disease is not exogenous; instead that its presence is determined by the quality of economic management.

Eggert (2002) disputes claims that mining produces enclave economies, instead arguing that the industry brings net gains in employment and that additional infrastructure from mining, such as roads, railways, water and electricity supplies, benefits the wider community.

Lastly, the link between natural resource wealth and the normalisation of civil war has been questioned. Ross (2003) argues that natural resources are unlikely to be the sole source of conflict and their existence alone does not guarantee violence. Instead, violence in resource-rich states is made more likely by the existence of underlying tensions, such as ethnic divisions. Ross finds that minerals only clearly increase the intensity of conflict in two of the 13 cases he studied. Of the remaining 11 cases natural resources played either no role, or had a mixed effect on the intensity of civil war. Ross (2003) argues there is little doubt that the existence of natural resources adds to the likelihood of civil conflict, however their presence alone is not sufficient to generate violence without the contribution of other underlying societal tensions.

While the resource curse literature continues to debate the pervasiveness of the paradox the scholarship remains state-centric. The emerging work on private governance regimes enhances our understanding of the governance of extractive industries and suggests that leadership over regulation of specific issue areas need not only emanate from the state.

Private Governance the New Research Agenda

The power of extractive firms has long been a focus for scholars. Marxists, such as Baran (1957, p. 132) and Frank (1966), explain the behaviour of colonial powers in relation to states in the periphery by suggesting that mining creates a "pool of pauperised labour" that discriminated against local populations. Frank (1966, p. 157) subsequently argued that mining creates a crucial link between the satellite and metropolis that once concluded leaves the satellite with a complete lack of development tools. Such theorists, and others affiliated with dependency theory and world-systems theory, argue that states in the periphery remain exploited by those in the centre due to their neo-colonial interpretation of extractive industries.

Subsequent decades saw the scholarship on state-firm interaction swell, with authors such as Strange (1988, 1996) and Friedman (2000) suggesting that globalisation would lead to the retreat of the state in favour of powerful multi-national firms. This theme continued in the literature with scholars suggesting that firms would 'regime shop' or look for the lowest common denominator in an effort to extract themselves from any social or environmental obligations (Thelen, 2004).

Following the realisation that globalisation did not spell the demise of the state, a more moderate scholarship developed which examines methods by which firms develop and exercise private authority. In particular, Cutler, Haufler and Porter (1999), Fuchs (2007), Dashwood (2007) and Kollman (2008) have developed frameworks that can be applied to the interaction between international extractive firms and developing state governments. These frameworks outline methods by which firms develop private authority and the ways in which this authority is used to develop private governance over issue areas.

Private authority is defined as the ability of non-state actors to "perform the role of authorship over some important issue or domain" (Hall & Biersteker, p. 4). Cutler et al (1999, p. 362) see private authority as "decision-making power over an issue area that is generally regarded as legitimate by participants". The inclusion of the term legitimacy in Cutler et al's definition is pivotal, private authority can create legitimacy however it also relies on this concept for effectiveness. Furthermore, private governance can be defined as "the interactions among private actors...[which] give rise to institutional arrangements that structure and direct actors" (Falkner, 2003, pp. 72-73). Private governance suggests repeated cooperation which is more reliable than market interaction, leading to accepted rule and regulations over issue areas – often directed and driven by firms.

Both private authority and private governance mechanisms are visible in the extractive sector, at a domestic and international level. All mineral producing countries have national mining associations with these bodies able to shape dialogue, influence firm behaviour to promote higher operating standards, and direct global governance of their industry (Dashwood, 2007). Many mining firms have also developed their own set of accords or cooperated on an inter-firm basis or on a multi-stakeholder basis with NGOs (Dashwood, 2007). Various private governance regimes have been formed including public-private partnerships (PPPs) used to own, operate and manage mines as well as the formation of multi-stakeholder initiatives. The ability of extractive firms to control the creation and direction of these agencies highlights the influence and power of private governance mechanisms.

It is often assumed that extractive firms are adverse to regulation, however in many instances the development of global standards is preferable to the regulatory variances and uncertainty mining firms face in the countries in which they operate (Dashwood, 2007). Mining firms are motivated to participate in private governance initiatives due to their restricted mobility and subsequent need to satisfy local communities where they operate. The nature of mining, specifically the requirement that minerals are extracted where they are found, means that good community relations are essential, with a 'social license to operate' seen as critical (Dashwood, 2007).

In the case of the mining industry the preeminent private governance mechanisms is the Extractive Industries Transparency Initiative (EITI) (Dashwood, 2007). The EITI is a multi-stakeholder approach with a primary goal of improving management of resource revenues in developing states. However, the implementation of private governance regimes, including the EITI, has lead to mixed outcomes in the context of developing states. Zambia's membership of the EITI highlights the potential pitfalls of reliance on public-private partnerships (PPPs) to set sufficient governance standards

The role of private governance regimes such as the EITI must be examined critically if the drivers of the resource curse are to be fully understood. This should lead scholars to question whether various private governance regimes help to fill the institutional void in developing states, or serve to further entrench the outcomes more commonly associated with the resource curse? Zambia's experience with the EITI is indicative of the importance of a multi-actor understanding of governance and is explored below.

An Application to Zambian Copper Mining

Zambia's copper wealth has over time been controlled by trading companies, colonisers, national governments and international investors however it has historically failed aid development in that country. Between nationalisation at independence and subsequent neoliberal reform, Zambia's economic performance has worsened while its development measures have remained stagnant. A multi-actor approach, as outlined above, assists in understanding Zambia's current plight.

Copper mining began in Zambia in the early twentieth century, however it wasn't until the 1930s that significant revenues were earned from the industry. Extraction rates grew throughout the 1950s reaching a peak of 700,000 tonnes per annum between 1969 and 1976 (Extractive Industries Transparency Initiative, 2012b). The extraction of copper led to Zambia being classified as a middle income country, and one of the richest in sub-Saharan Africa upon independence in 1964 (Lungu, 2008, p. 544). The country is now ranked 164th in the United Nations Human Development index with 64% of the population living below the poverty line (United Nations Development Bank, 2012). Yet, Zambia is currently the world's 8th largest copper producer and is expected to overtake Australia and Indonesia to become the 5th largest over the next decade. This paradoxical outcome typifies the resource curse and leads to the question, how did Zambia, richer and more advanced than neighbouring states, fail to experience mineral-led export growth? And what role have private firms and private governance regimes played in perpetuating this outcome?

A slump in copper prices during the 1970s led Zambia into economic turmoil. While the country's mines had previously provided a cradle to grave welfare state for its citizens government spending had seen debt spiral out of control. Between 1983 and 1985 Zambia was forced to rely on IMF and World Bank loans and in return implemented the institutions' Structural Adjustment Program (Bauer & Taylor, 2005). However the government was unhappy with the resulting increase in debt levels and suspended the program until further support was required six years later (Bauer & Taylor, 2005). In 1991 the government entered into an IMF Structural Adjustment Program focused on the liberalisation of the economy, specifically through the sale of government assets including the country's, by then, dilapidated mines (Lungu, 2008). The state of the mines, combined with another drop in world copper prices, meant the mines were highly unattractive to investors. Compounding this problem, figures within the Zambian government delayed the sale of the mines, despite receiving offers from a consortium of miners in 1997 and 1998, in order to safeguard salaries related to the management of the mine sale process (Bauer & Taylor, 2005). By 2000, in order to meet the demands of the IMF Zambia was forced to engage the assistance of the World Bank (and its partner the Rothschild Investment Bank) to design a package intended to immediately attract buyers. The resulting sales included significant contractual concessions to buyers, such as low royalty and taxation rates as well as the ability for new investors to write off losses for previous years. The sale of the mines was far more beneficial to buyers, than the government of Zambia, and has had long running ramifications for the government's ability to effectively tax the sector. Recent reports suggest that while mining accounts for 80% of government earnings it contributes less than 2% to government revenue

(Think Africa Press, 2012). Additionally, the ability of firms to write off losses incurred over the past ten years, as well as all capital expenditure, has meant that only 15% of government revenue from mining is paid in the form of corporate tax. The government accrues almost twice as much income from employee pay-as-you-earn tax (Extractive Industries Transparency Initiative, 2012b).

The nature of the relationship between Zambia and its investors is under-acknowledged in the resource curse literature. Since the sale of the mines Zambia has been forced to negotiate with up to a dozen international mining firms, all of which possess significant structural power over the state due to the investment and income that accompanies their presence (Fuchs, 2007). During 2007-2008 popular disillusionment with mine owners, specifically over their reluctance to fund social welfare, environmental and occupational health and safety programs, led to government efforts to normalise the mining industry taxation system. The government initially suggested increasing royalty and corporate tax rates from 0.6% and 3% to 25% and 30% respectively (Haglund, 2010, p. 100). These changes were met with indignation and rejection. The resulting negotiations saw the tax rate increases accepted in return for the dropping of a proposed windfall gains tax and the continuation of capital write off schemes for firms which enable them to declare themselves unprofitable and not liable to pay corporate tax.

Royalty and corporate tax rates have since been raised to 6% and 35% respectively there remains significant resistance from within the industry. Adam Little, Head of Tax at First Quantum Minerals which operates two copper mines in Zambia was quoted as saying that the company would like “some assurance for maybe 15 years that the tax rates would be as you see them now” (Mfula, 2012). In addition, Little urged the government to consider reducing the recently increased royalty rate from 6% back down to 3-4% citing support from other mining firms (Mfula, 2012). Further to protestations over the increased tax rates the World Bank has also recently highlighted that firms are still evading taxation obligations through either manipulation of the capital investment write off scheme or through transfer pricing schemes (Haglund, 2010, p. 95).

The normalisation of the taxation system provided an opportunity for a leading mining firm operating in Zambia to exhibit private authority. An acceptance of and adherence with the increased taxation rates, including the cessation of tax avoidance through capital write offs and transfer pricing would equate to private authority over the issue area of taxation. This authority would potentially lead to wider acknowledgement of best-practice across the industry and adoption of such practices by other firms. Firms may be motivated to self-regulate in response to their own interests, opposition from local communities or shareholder activists in their own states. The actions of private actors in promoting regulation over issue areas is not based on altruistic assumptions, the private governance literature suggests that these actions are motivated by firms' profit motive and a desire to maintain a 'social license' to operate where they mine.

With firms refusing to cooperate in the development of an improved taxation system the Zambian government turned to the EITI as a solution. Zambia became a EITI 'Candidate Country' in 2009 and achieved 'Compliant Country' status in September 2012 - the first country in East and Southern Africa to do so (Extractive Industries Transparency Initiative, 2012a). With the support of Western donors, Zambia engaged with the EITI in an attempt to improve transparency of its mineral extractive sector. The 2009 EITI Zambia report shows very little discrepancy between tax declared as received by the government and that declared as paid by firms, leading to suggestions the EITI has been a success in Zambia (Extractive Industries Transparency Initiative, 2012b). However, further analysis suggests that this particular private governance regime has failed to improve Zambia's experience with copper mining. The EITI, like the literature on the resource curse, relies largely on the assumption that increased transparency is the 'Swiss army knife of policy tools' (Haufler, 2010). This assumption is derived from the scholarship that assumes that government misuse of rents is the sole cause of the resource curse. Instead, in the case of Zambia we see the government unable to collect sufficient taxation from the mining industry with firms able to use their structural power to avoid their obligations. This point is supported by the fact Zambia's largest miners, subsidiaries of Vedanta Resources and First Quantum Limited, have thus far refused to lend their support to the EITI.

The Zambian government's decision to join to the EITI was an attempt at privatising regulation of the industry, as previous attempts at industry reform had failed. The failure of Zambia's economy to grow in line with copper prices and export levels has often been cited as a case of the resource curse, as is understood through traditional channels such as the government mis-allocation of rents. However, on closer examination the role of the state must be analysed in conjunction with the actions of extractive firms. These firms were able to build significant private authority through the lobbying of the World Bank during the original liberalisation process, which included the sale of the mines. Since then these firms have benefited from generous concessions provided to them and have resisted efforts at normalising taxation and royalty rates. The Zambian government has since joined the EITI process, an attempt at privatising the governance of these firms through the prominent industry self-governance mechanism. However, it remains to be seen if this attempt at regulating the sector through the promotion of private regulation will be successful. A lack of support for the initiative from the country's two biggest miners does not suggest that private governance in the Zambian extractive industry is likely to enhance the effectiveness of existing regulation or strengthen state institutions. Furthermore, Zambia's implementation of the EITI program allows these two large players to assure investors abroad that they are complaint with rules and regulations supporting transparency, despite a deliberate absence of support for the initiative.

Conclusion

The resource curse literature remains focused on the debate over the pervasiveness of the paradox. Instead, it should be acknowledged that developing states, rich in natural resources are likely to experience some or all of the outcomes commonly associate with the resource curse. The emerging literature on private governance is being applied to the extractive sector of developing states, providing a more accurate picture of governance of these industries. As can be seen from the case of Zambia, the resource curse is not simply about the misuse of rents by governments on behalf of their citizens. The Zambian government has thus far been unable to collect significant rents from its copper industry and instead faces significant resistance from the firms who invested in this industry. International investors are able to utilise their power, relative to the government, to avoid industry taxation reform. Membership of the EITI was intended to outsource this reform, yet thus far very little has been achieved. While Zambia's copper output increases the country still remains desperately poor.

The case of Zambia highlights the importance of a broader understanding of governance, particularly for scholars of the resource curse. If the curse is to be fully understood all potential drivers and solutions must be considered, including the role of private governance in the industry. An application of the new research agenda being put forward by private governance scholars, to future studies of resource cursed countries will improve existing understandings of what causes this paradox. It is clear from the case of Zambia that traditional definitions of the resource curse, which rely on the state as the sole form of governance, are failing to explain the country's continued stagnation. Zambia's resource curse is caused, in part, by the significant private authority of firms and the inability of private governance measures such as the EITI to temper this – a fact that is under-recognised in the literature.

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