POLICY BRIEFING 14

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Will Oil Build or Break the Back of Ghana's Democracy?

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RECOMMENDATIONS

- Legislation covering Ghana's oil revenue management should be passed without further delay. This will provide economic stability and political confidence that the legislature is adequately performing its democratic oversight role. Concomitant to this must be the establishment of stabilisation and heritage funds to ensure a wise stewardship of the natural resource that is Ghana's oil.
- Strong local negotiating skill should be immediately funnelled into negotiating oil contracts. Especially important is transparency and the need to avoid 'stabilisation clauses'.
- Concrete plans to utilise Ghana's gas deposits as a backbone for a new industrial policy framework should be crafted and finalised. Such plans will ensure economic diversification without undermining agriculture.
- Local communities must be consulted to ascertain what they themselves think can be accomplished through oil revenues. In the process, expectations will be managed and development aspirations met.

EXECUTIVE SUMMARY

Ghana is about to start producing oil commercially. Amid great excitement, there is also legitimate cause for concern. Given the importance of economic diversification and the need to consolidate democratic institutions to avoid a resource curse, this paper analyses how well Ghana is poised to harness developmental benefit from new oil revenues.

INTRODUCTION

History demonstrates that a healthy caution is necessary when it comes to managing oil revenues.[2]

Ghana has much to offer, having broken other African precedents. As the first country to gain independence in 1957, it made history by staging a series of free and fair elections in recent years. Twice — in 2002 and again in 2008 — the opposition party won, and the incumbent stepped down in a display of respect for democracy. This is groundbreaking progress, given that only a handful of African countries have met this benchmark of democratic consolidation after independence.[3]

ECONOMIC OVERVIEW

Ghana's economy remains highly dependent on primary commodities, with cocoa making the greatest contribution to gross domestic product (GDP) and exports. As an economic mainstay, it is labour intensive and contributes to employment. Mining, mostly in the Western region, also contributes strongly to GDP and exports, but civil society and aid organisations say that it has brought little or no benefit to local communities.[4] Likewise with timber extraction. Now there is oil to be exploited about 60km offshore in the same region. Given the previous lack of benefit to local communities, expectations that oil revenues will make a difference are running high.

Despite dependence on primary commodities, Ghana's stability and apparently prudent economic policies have enabled a strong economic growth rate,[5] and poverty has been reduced from 53% to 28% between 2003 and 2008, making it one of the few countries in Africa to meet its Millennium Development Goals ahead of schedule.[6] However, that progress is measured by a narrow definition of poverty: 80% of the population still live on under $2 a day.[7]

INSTITUTIONS MATTER

'Democratic institutions' stem from norms that have become formalised and honoured by a critical mass within government and society. The underlying principle of these institutions is that they respect the public voice and ensure a check on power. For instance, parliament plays a crucial oversight role in preventing executive abuse of power. Together with free and fair elections, a healthy and vocal civil society is crucial to consolidating democracy. Media freedom (and independence), the right to access information, and the right to association are generally recognised as being integral to this consolidation too.

Ghana boasts a strong civil society representing a broad spectrum of philosophies, and the media offers a critical voice without fear of reprisal. The tax base is relatively narrow,[8] though, and Ghana relies heavily on foreign expertise and aid for revenue. This is a double-edged sword, and aid organisations themselves appear to be aware of that. On the one hand, it can be useful to choose from a range of consulting advice. On the other, it can create overwhelming pressure to conform to one set of donor's prescriptions at the expense of another. If oil revenues do not produce their propagated benefit, it is easy to conclude that the wrong advice was dispensed.

HOW SIGNIFICANT IS OIL REVENUE, REALLY?

Oil revenues are likely to peak within seven years. They are expected to provide an average of about $1 to 1.5 billion a year.[9] This is a significant addition to current revenues of about $3.7 billion. This can be a blessing and a limitation. Both civil society and aid organisations recognise Ghana's lack of absorptive capacity[10] — especially at local government level. This means that the country is unlikely to be able to spend extra immediate revenue fruitfully. Oil prices tend to be volatile, creating a difficult investment environment. In addition, if the budget depends too heavily on oil, then budget volatility is likely, which undermines planning, a key component of developmental success. These organisations are therefore adamant about the need for a stabilisation fund that will perform three essential functions: First, use oil revenues to smooth the budget; second, that they should be invested in a heritage fund to ensure compound interest earning and a store of value for future generations; and third, that they should be used to enhance human capital, especially in government departments. This would help to improve capacity and ensure better public service delivery.

HOW TO SPEND THE OIL WINDFALL?

There appears to be a broad consensus in Ghana that oil revenues should not be injected into immediate capital or operational expenditure,[11] although it must be tempting to spend it on narrowing the current fiscal deficit. The country is aware of the inflationary pressures that such spending could cause. For example, the Danquah Institute of Accra is adamant that the oil windfall should be invested primarily in research and development to enhance Ghana's knowledge economy.[12] Without technological progress Ghana will not graduate from dependence on primary commodities. It needs higher-return products to become more globally competitive. Finally, a sober awareness exists that oil in itself is unlikely to produce any structural economic changes,[13] even if immaculately managed. Economic diversification, not oil per se, is imperative for Ghana's developmental success.

OPPORTUNITIES FOR ECONOMIC DIVERSIFICATION

However, capturing the gas released by oil extraction does provide exciting developmental opportunities. The Integrated Social Development Centre (ISODEC), a budget advocacy group, foresees gas providing the backbone of a new industrial policy framework.[14] This would work by improving energy production, transmission and distribution through the region, in addition to increasing fertiliser production that would exponentially improve Ghana's agricultural yield. Oil exports have a tendency to inflate falsely a country's currency and so undermine the export competitiveness of other sectors. Agriculture is the primary export earner and the biggest employer. The implications of such a scenario are devastating. Careful management is needed to ensure that gas improves the agricultural yield and that economic diversification builds on agri-business rather than undermines it.

OIL REVENUE MANAGEMENT — WHAT IS GOING ON?

A major institutional concern is delay in legislating the Oil Revenue Management Framework, which was tabled in 2008 (under National Patriotic Party auspices) and subsequently withdrawn by the National Democratic Congress when it took power in January 2009. Given that parliamentary oversight is an essential democratic function, sceptics fear that the delay signals legislature weakness. In addition, oil contract negotiations are shrouded in legislative and contractual secrecy. One government minister has opined that oil is 'Ghana's last hope'.[15] If the delay in passing vital legislation is an indication that Swiss bank accounts and elitist patronage networks are being established, then civil society has legitimate cause for concern.

Some development organisations emphasise the difficulties that the Ghanaian government faces.[16] First, there were purportedly genuine concerns about the withdrawn petroleum bill (tabled in haste during an election), and in any event legislation governing oil and mining needed to be rationalised. Second, most of government's negotiating strength lies in the ministry of foreign affairs, which has yet to be called in. This strength needs to be harnessed to avoid exploitative 'stabilisation clauses' favoured by international oil companies to protect themselves against 'inconvenient' legislation concerning matters like environmental responsibility or local content requirements.[17] Both issues are crucial to Ghana's long term development. Lack of capacity has also resulted in the Ghana National Petroleum Company playing the role of player and referee — not an ideal arrangement as it undermines independence and constitutes a strong conflict of interest. However, it is confidently expected that this will change once a separate National Regulatory Authority has been commissioned. Third, an array of political and business interests are involved in Ghana's oil. From offers by corporate investors to advice from aid organisations and international financial institutions — it is difficult for the government to know whom to trust. Transparency would help a great deal, but the neo-realist perspective still carries weight: multinational corporations are far wealthier and more powerful than Ghana, and if they perceive that minimal transparency is in their profit-maximising interests, then government may acquiesce to their demands. This is especially true where immediate cash is tempting and negotiating capacity is weak.

IRONIES OF A POLITICALLY COMPETITIVE ENVIRONMENT

Democratic consolidation is laudable, but attaining it carries unavoidable tradeoffs. Developmental prudence does not always match the timing of a competitive political environment. In Ghana's case, it may be very tempting for an incumbent government to spend oil revenues on whatever it perceives will ensure its continuation in power. However, the previous government made outrageous promises about what oil revenues could bring, overspent the budget — and lost the election. This suggests a savvy electorate. Dashed hopes have produced a healthy wariness of politicians' promises, a sign of maturing democracy.

WHAT ABOUT CONFLICT?

Despite recent political stability, the possibility of unrest remains.[18] Expectations are running high that oil will bring benefits long denied.Delay in passing legislation has not been accompanied by communication of what progress is being made. Communities are starting to become agitated about the lack of transparency over oil contracts.

Perhaps the greatest lesson, then, is that communities should have been far more widely consulted beforehand. Government has unwittingly allowed unmet expectations to germinate and fester.

If communities are given the chance to articulate what they want to accomplish with oil revenues, then they can create — and work to fulfil — their own expectations.[19]

CONCLUSION

In the final analysis, the answer to the title question is ambiguous at best. Oil is unlikely to shake the core of Ghana's democracy, although the dangers should never be dismissed. But if its revenues are well managed, it can strengthen democratic institutions and produce fruitful developmental outcomes.

ENDNOTES

1 Ross Harvey is an intern with SAIIA. He is completing his Masters thesis in Public Policy at the University of Cape Town.

2 See, for example Rosser, A, 'The political economy of the resource curse: A literature survey', Institute for Development Studies (IDS) Working Paper, 268. Brighton: IDS, 2006.

3 Benin, Madagascar, Mali, Mauritius and Senegal are the only countries to have achieved this feat. See, for example, <http://africanelections.tripod.com/index.html> and Lindberg S, 'The surprising significance of African elections', *Journal of Democracy*, 17, 1, 2006.

4 This consensus — explicitly conveyed in meetings with various civil society institutes and development aid agencies — stands in marked contrast to some of the academic literature. See, for example Aryee B, 'Ghana's mining sector: its contribution to the national economy', *Resources Policy*, 27, 2001, pp. 61–75.

5 However, the World Bank is concerned at the magnitude of the fiscal deficit that was ironically incurred (in part) through election campaign spending by the previous government.

6 World Bank, *Economy-Wide Impact of Oil Discovery in Ghana*, Report No. 47321-GH, 30 November 2009.

7 Oxfam America and ISODEC, *Ghana's big test: Oil's challenge to democratic development*, p. 7.

8 A broad tax base can be a strong mechanism through which to ensure that the citizenry hold government accountable. See, for example Ross M, 'Does Taxation Lead to Representation?', *British Journal of Political Science*, 34, 2004, pp. 229–249.

9 World Bank, *Economy-Wide Impact of Oil Discovery in Ghana*, Report No. 47321-GH, 30 November 2009: 'The World Bank's central estimate puts potential government revenue at $1 billion on average per year between 2011 and 2029'.

10 Oxfam America and ISODEC, *Ghana's big test: Oil's challenge to democratic development*, p. 45. Absorptive capacity refers to the ability of an organisation to absorb and spend revenue fruitfully. If sound financial management and competent human capital is absent, more revenue is likely to be more of a burden than a blessing.

11 Even the World Bank argues against this immediate spending which is likely to increase GDP growth by 4% a year. See, for example World Bank, 'Economy-Wide Impact of Oil Discovery in Ghana', Report No. 47321-GH, 30 November 2009, pp. 40–41.

12 Interview with Professor Gabby Asare Otchere-Darko, Danquah Institute, Accra, 1 December 2009.

13 World Bank, *Economy-Wide Impact of Oil Discovery in Ghana*, Report No. 47321-GH, 30 November 2009, p. 45: 'Ghana's manufacturing sector is heavily underdeveloped, and has not shifted much in the last two decades'.

14 Interview with Kofi Ayivor, ISODEC, Accra, 3 December 2009.

15 *The Daily Graphic*, 'Oil, our last hope: Deputy Energy Minister declares', 1 December 2009.

16 Interview with Dr Cheryl Gopaul, Romeo Adomah-Darteh, Barbara Hogan (Canadian International Development Agency — CIDA), and Emil Stalis, USAID, Accra, 3 December 2009.

17 Oxfam America and ISODEC, *Ghana's big test: Oil's challenge to democratic development*, p. 31.

18 Interview by Mari-Lise du Preez, SAIIA, with Ernest Lartley, Kofi Anan Peacekeeping Centre, Accra, 2 December 2009.

19 This point was raised in a personal conversation — after SAIIA's interview with CIDA and USAID — with Romeo Adomah-Darteh, the Senior Environmental Analyst/Advisor for CIDA.

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