

# **Extracting Ghana's Potential: Dodging the Resource Curse and Promoting Development**

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## **Executive Summary**

Ghana's recent oil discovery has led to optimism over its economic future. The potential revenues are considered to be a solution to the country's human and economic development issues. However, in developing countries, oil wealth is often associated with poor economic performance, socioeconomic inequalities, corruption, and conflict – a paradox that has been coined the 'resource curse.' In order to beat the resource curse, Ghana must determine how to wisely use its newfound profits. To determine what reforms are necessary to best promote economic and human development, Ghana must perform a critical assessment of its constraints, challenges, and opportunities. In order to best utilize oil revenues, the government of Ghana must increase its institutional capacity, promote a robust governance framework, and stabilize its economy. Once these institutional reforms have been implemented, the government can determine how to best invest oil revenues, to foster economic and social development, and to create a sustainable future.

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## List of Abbreviations and Acronyms

Africa Infrastructure Country Diagnostic	AICD
African Development Bank	AfDP
African Economic Outlook	AEO
Business Sector Advocacy Challenge	BUSAC
Central Intelligence Agency	CIA
Democratic Republic of Congo	DRC
Department for International Development	DFID
Economic and Financial Crimes Commission	EFCC
Energy Information Administration	EIA
Extractive Industries Transparency Initiative	EITI
Ghana National Petroleum Corporation	GNPC
Ghana Shared Growth and Development Agenda	GSGDA
Gross Domestic Product	GDP
Human Development Indicator	HDI
Information and Communication Technology	ICT
International Financial Corporation	IFC
International Monetary Fund	IMF
Millennium Development Goals	MDG
National Development Planning Commission	NDPC
National Oil Company	NOC
Official Development Assistance	ODA
Organization for Economic Co-operation and Development	OECD
Private Public Partnership	PPP
Sovereign Wealth Fund	SWF
United Kingdom	UK
United Nations Development Programme	UNDP
United Nations Economic Commission for Africa	UNECA
United States	US
Water Supply and Sanitation	WSS
World Development Indicators	WDI
World Governance Indicators	WGI

# Introduction

## Background

Ghana was the first sub-Saharan African colony to gain independence in 1957 (GSGDA 2010, 2). However, the first autonomous decades were plagued by power struggles and military coups. In 1981, Lieutenant Jerry John Rawlings ascended to power, and dissolved the constitution, political parties, and opposing forces (CIA 2012). During the subsequent decade, Ghana saw a steep decline in economic and human development. In 1992, the Ghanaian government adopted its current constitution, and a multiparty democracy was restored (GSGDA 2010, 2). While Rawlings maintained power as elected president through the 1990's, the government worked with the International Monetary Fund (IMF) and World Bank to adopt structural adjustment plans to change economic policies. Under these policies, as well as an influx of foreign development aid, Ghana's economy and human capital began to recover and further develop. (Obeng 2010, 85). Since 2000, the government has experienced two presidential elections, which saw power transfers between two independently and legitimately elected leaders and political parties. In the past two decades, Ghana has established itself as a reliable presidential democracy, and one of the most stable governments in West Africa. Resulting from its relative stability, Ghana has made great developmental progress, yet still faces many challenges.

Ghana discovered oil reserves in the Gulf of Guinea in the 1970's. Until recently, however, the reserves remained largely unused, and production negligible. With increasing global oil demands, Ghana has the potential to exploit its resources, and has encouraged further oil

exploration. In the past decade, further discoveries have been made, and the amount of oil reserves has increased. Ghana must develop sound policies and effective governance institutions to combat the ‘resource curse,’ which has plagued much of the region. By examining the policies and governance models of cases that exemplify success and failure, Ghana can find guidance on methods to turn the resource curse into a resource blessing. Ultimately, this policy report attempts to analyze how Ghana can avoid the resource curse, and utilize these newfound revenues to promote human and economic development.

### **Oil Reserves and Economic Impact**

Ghana recently discovered greater expanses of offshore oil reserves, which has been greeted with an optimistic promise of economic revenue and growth. The Jubilee Field, located off the Western Atlantic coast, has estimated reserves totaling 490 million barrels, though further exploration could prove more. The oil reserves are comparable to neighboring countries, as indicated in Table 1. Ghana’s closest neighbor, Côte d’Ivoire, has 100 million barrels in its reserves, and nearby Cameroon has 400 million barrels. However, these reserves are considerably less than West Africa’s largest oilfields in Nigeria, which total 36,200 million barrels (World Bank 2009, 1). Still, Ghana’s estimated reserves are the sixth largest in Africa. Extraction recently began, with 2011 being the first year of substantial crude oil export. Total extraction is expected to top 120,000 barrels per day. However, currently, export is about half of full capacity, due to a lack of local expertise and issues with infrastructural capability (Danquah 2012). Still, oil production is expected to peak between 2012 and 2016 (World Bank 2009, 1).






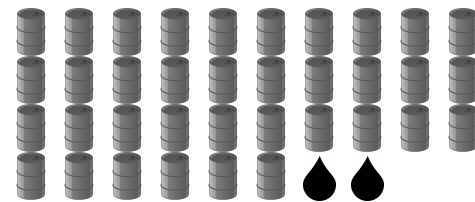
Ghana's Gross Domestic Product (GDP) grew at a rate of 13.5% in 2011 (CIA 2012), and is estimated to increase by 11% in 2012, predominantly resulting from its oil export (AEO Ghana 2012). However, projected oil revenue is dependent on volatile prices. In 2009, the World Bank created revenue scenarios based on the expected reserves and various price points. As illustrated in Table 2, oil revenues are highly sensitive to



prices. Regardless of price volatility, global oil demand is expected to increase, resulting in higher prices. Even using conservative figures, Ghana is expected to earn at least an additional US\$1.0 billion per year between 2011 and 2029 in oil exports (World Bank 2009, 1). Given the government's current revenue of US\$7.3 billion and GDP of US\$38.6 billion, oil exports will have a great budgetary impact (CIA 2012).

## Defining the Problem

In the short- and medium-runs, oil revenues could have a significant impact on Ghana's current economic issues and constraints. The Ghanaian government will need to broaden its institutional capacity to absorb these revenue gains, and convert them into sustainable and effective long-term solutions for economic growth and human development. However, with resource wealth comes additional challenges. Historically, sub-Saharan Africa has suffered from poor governance and

**TABLE 1:** Comparison of Estimated Oil Reserves, by Country

Country	Estimated Oil Reserves
<b>CAMEROON</b>	
<b>CÔTE D'IVOIRE</b>	
<b>GHANA</b>	
<b>NIGERIA</b>	

Reference:  equals 100 million barrels .  
 equals 1,000 million barrels .

Source: World Bank 2009, 1

low human and economic development. Many of these countries have great potential to utilize their natural resource wealth to stimulate their economies, and provide the necessary financing for human capital investment. However, in many instances, this resource wealth has become a resource curse. Instead of experiencing the anticipated economic wealth associated with such resource abundance, development has actually declined. Many hypotheses have attempted to explain this counter-intuitive phenomenon, including market volatility, corruption, weak governance, mismanagement, and lack of market diversification. While academic debate often attempts to standardize and quantify the reasons behind the resource curse, effective policy solutions will analyze each situation in the context of each case.

Institutionally and politically, oil revenues must be managed as a public good rather than satisfying personal gains or creating a local elite. Additionally, the government must effectively manage its revenues and expenditures, and implement stabilizing macroeconomic policies, despite volatile and uncertain global oil prices and demand. If able to overcome these challenges, the

**TABLE 2:** Projected Annual Government Revenue of Ghana's Oil Fields, by Price-Points

Price Assumption (US\$ per barrel)	Potential Government Revenue (US\$ billion)
30	3.0
50	8.6
75	19.4
100	29.3

*Assumptions:* Extraction is operating at full capacity of 120,000 barrels per day. Averages calculated over fields' lifespans, starting in 2011 and ending in 2029. Capital upfront cost of US\$4 billion is deducted.

*Source:* World Bank 2009, 20-1

Ghanaian government can maximize long-term growth and development, and avoid what has documented as the 'resource curse.' The nature of these challenges and solutions will be explored in the subsequent sections. Ultimately, these considerations will be applied to Ghana-specific constraints and policy recommendations, to articulate how Ghana can avoid symptoms of the resource curse.

## **Organizational Structure**

This thesis policy report will focus on the potential downfalls of resource wealth, how such risks can be mitigated, and what institutional reforms are necessary to circumvent the resource curse. The first section will define resources' impact on development, by looking at the challenges and benefits of natural resource wealth. This section will highlight the role of institutions, governance, and policies, to accommodate the impact of windfall gains. The second section will examine the current political and economic constraints in Ghana, to define potential opportunities and threats that may be enhanced or exasperated by its recent oil discovery. Too often the resource curse is simplified in terms of economic growth, without analyzing human development factors; the second section will highlight oil revenues, as a financial source for investing in Ghana's development needs. The penultimate section will tailor specific policy recommendations and reforms. Policy models and examples will be tailored to Ghana's specific needs, challenges, and opportunities. This section will highlight policies that promote institutional capacity, encourage economic growth, and deliver sound public investment strategies. The policy report's concluding section will summarize how to best direct Ghana's oil revenues, to create a strong and sustainable economy, and to promote human development.

# **Resources' Impact on Development**

## **Introducing the Paradox**

Many scholars have debated the implications and relationships between resource wealth and economic development. Common economic theory stipulates, “sustained economic growth is achieved with sustained and successful industrialization” (Di John 2011, 167). However, the concept of industrialization has shifted with modernization and globalization. Determinants of an industrializing nation no longer follow the traditional historical trajectory, whereby a country can solely rely on its natural resources to stimulate exports, attract capital, and develop labor (Di John 2011, 167). In contemporary economics, developing, resource rich countries have been ‘cursed’ by their apparent resource wealth. Since the 1960’s, resource wealthy countries have been inexplicably plagued by conflict and low economic and human development, compared to their resource poor counterparts (Sachs 2001). The phenomenon has been dubbed the ‘resource curse.’ While most scholars agree to some relationship between resource wealth and development, the causal link and its affects are disputed (Okpanachi 2011, 26).

## **The Resource Curse**

Since the 1990’s, there has been growing literature that attempts to describe the root causes of the apparent resource paradox, that is, why countries with resource abundance have experienced economic and political failure. Structuralists have attempted to prove an empirical causal relationship between resource wealth and low development. Empirical studies were conducted to illustrate a resource’s impact on macroeconomic instability, resulting from price volatility, trade imbalance, and inflation (Iwayemi 2010, 603). These factors are believed to cause economic collapse, resulting from the volatility of commodity markets, overreliance on rents as state

income, and lack of competition and diversification on non-resource markets (Sachs 2001). Nigeria, containing some of the greatest oil and gas reserves in the world, is often cited as exemplifying the resource curse, as discussed in Box 1. Despite its resource wealth, Nigeria has been afflicted with hyper corruption, great poverty, and low economic and human development.

### *Socioeconomic Repercussions*

The economic ramification of resource wealth is often associated with Dutch disease (Leong 2011, 2). As resources inject increasing revenues into a country's economy, real exchange rates increase (Leong 2011, 2). As a result of such an appreciation, country national savings are reduced and prices are distorted, as the country experiences export-oriented consumption and production (Wiebelt 2011, 746). This bias towards an export-led economy will negatively affect the manufacturing and agricultural sectors, as greater emphasis and expenditures will shift from high-skilled and high-tech manufacturers to low-skilled and low-tech sectors and laborers (Leong 2011, 2). Further, price volatility on many commodity markets leads to revenue volatility, which disrupts a government's budgetary planning and discretionary spending. As a result, governments may have to cut from their projected budgets – adversely affecting programs and projects – or have to borrow from foreign investors, which increases national debt and further deteriorates the country's economy.

Poor economic management, according to dependency theory, has a significant impact on increased risk of violence, low economic growth, poor governance, hyper-corruption, and decreased human development (Obi 2010, 483). Further, the large windfall gains associated with resources provide the incentive for government officials, elites, and company executives to

partake in highly corrupt, rent-seeking opportunities. In an effort to consolidate power, many government officials and elites allocate resources and funds to favored constituents or regions to gain votes and support. Additionally, these corrupt individuals may siphon revenues for personal gain, instead of working in the country's best interest, a symptom of the principal-agent problem (World Bank 2009, 26).

**Box 1: Resource Curse, the Case of Nigeria**

Nigeria has been considered the case that exemplifies the resource curse. Despite having the largest oil and natural gas reserves in Africa – tenth largest in the world – Nigeria has been plagued by poor economic growth, low human development, and domestic conflict (EIA 2011). Nigeria ranks as one of the poorest countries in the world, with 100 million, nearly 61% of the population, living on \$1 a day (Adeolu 2008 220). Between 1960 and 2011, Nigeria averaged minimal annual GDP growth (WDI 2011). The country is ranked 156 of 187 in human development (HDI 2011), and remains one of the most corrupt governments in the world (Transparency International 2011). Nearly 50% of Nigerians – 76 million – do not have access to electricity, and 81% rely on traditional biomass and waste for heating and cooking needs (IEA 2011). Unemployment is high, and environmental degradation is rampant, especially in the oil producing Niger Delta region (Adeh 2008, 284). The oil industry is largely blamed for the air, soil, and water pollution (EIA 2011), and its negative impact on local fishing and agriculture industries (Adeh 2008, 286). Further, regional and political conflicts have led to attacks and seizure of oil and gas infrastructure, and the kidnapping of industry personnel (Okpanachi 2011, 28). The Nigerian government has been largely ineffective in stabilizing and promoting human and economic development, resulting in the country becoming an emblematic victim of the ‘resource curse.’

As a result of governmental corruption and lack of effective governance, many have linked resource wealth with authoritarian regimes and failed states, which further impede human and

economic development. In a rentier state where resource revenues provide government profits, the government does not need to collect taxes, and is thus less likely to be held accountable for its actions and discrepancies. Since windfall gains reduce the need for governments to collect taxes, it is argued that the public does not require accountability, resulting in skewed power dynamics and poorly functioning governments. Many studies have argued that resource abundance leads to a negative impact on economic and human development, due to dependency and market failure (Di John 2011, 168).

### *Observed Cases*

Since the 1980's, African countries have been analyzed to empirically prove the existence of the resource curse. Small and large-scale case studies have shown that many resource wealthy sub-Saharan countries have indeed experienced restricted political rights and civil liberties, poor human and economic development, and high instances of corruption. From the 1980's onwards, researchers studied observed cases and indicators: Angola, the Republic of Congo, the Democratic Republic of Congo (DRC), Equatorial Guinea, Gabon, and Nigeria have all been designated as victims of the resource curse (McFerson 2009).

Political and ethnic violence and regional conflict are often correlated with resource wealth. In Nigeria, local militias, backed by political patrons, attack oil and gas infrastructure, creating regional conflicts, and threatening national stability and rule of law (Okpanachi 2010, 29-31). Politicians and elites pilfer revenues as political kickbacks to personal accounts, supporters, and strategic regions, instead of investing in human and economic development. UNDP reports that the lack of national attention has resulted in the Niger Delta "suffering from administrative

neglect, crumbling social infrastructure, and social services, high unemployment, social deprivation, abject poverty, filth and squalor” (UNDP 2006, 9). Likewise, the resource wealthy DRC has been riddled with violence, famine, and disease, resulting in the death of an estimated four million people (McFerson 2009, 1536). Control for the DRC’s vast resource wealth has led to ethnic and regional conflict, and, with no central government authority in many districts, militias and bandits continue to destabilize the DRC (McFerson 2009, 1536-7).

Corruption resulting in government officials diverting public resources for personal profit or vested interests has become emblematic of the resource curse. As a result, corruption has become one of the most prominent issues observed, particularly in sub-Saharan Africa. In Nigeria, the Economic and Financial Crimes Commission (EFCC) estimated that Nigeria’s ruling elite stole \$400 billion in oil revenues between 1960 and 1999 (Okpanachi 2010, 28). The Republic of Congo was denied World Bank and IMF funding as a result of its high corruption rate – nearly one-third of its US\$1 billion in oil revenues are not disclosed in the national budget. Similarly, in Angola, power is deeply centered on the president and his inner-circle. Consequently, resource allocation is biased towards the political elite, favoring overseas education and medical evacuation, instead of basic health and education expenditures (McFerson 2009, 1533). In Gabon, kickbacks and millions of dollars in overseas accounts have resulted in billions of dollars being misallocated, resulting in the country having less paved roads than oil pipelines (McFerson 2009, 1540).

When looking at the cases of resource wealthy countries in sub-Saharan Africa, low economic performance and poor human development appear to provide evidence that the resource curse exists. However, these failings should not be attributed to resources – commodities – themselves,



but upon domestic politics and national policies. The governments of these resource wealthy countries have failed to identify, and been unwilling to change, their policies to promote better resource management, fight corruption, and provide for common security and welfare.

## **Resource Blessing**

Despite evidence that suggest resource wealth is a curse, counter arguments point to resource rich countries that have developed their economies successfully, such as Canada, Norway, Saudi Arabia, and Indonesia. In sub-Sahara Africa, the case of Botswana is often cited as the eminent contradiction of the modern resource curse. The case is highlighted in Box 2; its success is largely attributed to sound policy, effective governance, and emphasis on institutional capacity. Citing these successful examples, evidence suggests that, in the long run, resource wealth leads to development. Proponents of this positive relationship argue that institutions and responsible resource management drive economic growth. The argument suggests that resource rich countries who implement effective institutions will find their resources a blessing, rather than a curse (Adelou 2008).

## *Reframing the Issue*

Recent literature suggests that previous studies attempting to determine causality between resource wealth and economic and political failure are biased. Since resource wealth is not an exogenous factor, it is ineffective in determining casual relationships (Haber 2011, 1). While resources may be purchased by exogenous actors and governments, and subject to global prices, a country's resources are subject to domestic jurisdiction and legal institutions. Additionally, critics argue that these studies have been conducted over a finite period of time with short-term

calculations, and are biased towards case-study heterogeneity (Haber 2011 1-2). It is criticized that economists who maintain the existence of the resource curse take a biased sample of predominantly sub-Sahara African countries, and conduct their studies based on short-term calculations from the 1960's onwards. Critics of the methodology employed argue that, if examining a time series, it is important to look at long-term effects and global examples. These critics contests that, despite a few recent instances where resources may have had a negative impact, generalized statements cannot be applied to all cases (Haber 2011, 25).

The complexity of the relationship cannot be captured in simple quantitative approaches. As Michael Ross has written, “measurement error, endogeneity, lack of robustness, and uncertainty about causal mechanisms” cannot determine causality (2006, 265). Further, generalized links and causal relationships cannot represent all cases. Each country will have different experiences and responses to control its resource wealth. There are too many variables – endogenous and exogenous, political and economic – that are unique to a country (Haber 2011, 2). Still, there are many cases where resource wealth merely provided a catalyst that further exacerbated poor human and economic development. However, it is not the resource that causes such failures. Prior institutions, and the inability to adopt more effective governance models, have led to instances of economic and human underdevelopment (Daniels 2011). In these cases, endogenous factors, such as macroeconomic mismanagement, political negligence, hyper-corruption, and historical grievances, further aggravate resource mismanagement. Ultimately, though, it is not the resource or the presence of the resource that implicates poor government control, but the state's ability to cope and manage its capacity, institutions, and policies; a country's governance is vital to managing resource wealth.

**Box 2: Resource Blessing, the Case of Botswana**

While much of sub-Saharan Africa has been politically and economically unstable, Botswana has proven to be the exception, despite dependence on its diamond resource wealth. Botswana has a relatively high reliance on its diamond resources, which peaked at 80% of its GDP in 1979 (Jerven 2010, 80), but has subsequently settled to 26% of GDP (AEO Botswana 2011, 5). While the diamond abundance has led to increased growth in the mining sector, the agricultural industry has decreased dramatically. As a result, Botswana's mining sector has been criticized for crowding out more sustainable economic industries (Jerven 2010, 80). Still, the ability for Botswana to obtain substantial economic growth and elevate itself from a least developed nation to a middle-income country, despite this overreliance, is notable. Botswana's economic growth has been attributed to the country's economic and political institutions. Recently, Botswana has attempted to diversify its industries, by focusing on manufacturing, tourism, and finance (AEO Botswana 2011, 6). The country, though facing high inflation, runs budget surpluses, and is averse to running large international debts (AEO Botswana 2011). To increase domestic and foreign direct investments, Botswana has consistently adopted a transparent and predictable legal framework that assures financial security, and is ranked as the least corrupt nation in sub-Saharan Africa (AEO Botswana 2011, 3).

*Governance and Institutional Capacities*

Governance broadly refers to the management of policies and power. Therefore, the direct governance of economic and social resources determines a country's development. How a country is able to manage and adapt to exogenous and endogenous factors, such as resource wealth, determines how effective it can govern and implement policy (Adeolu 2008, 221). Good governance implies effective administration, institutional capacity, and management of resources, as well as the ability to anticipate challenges and effectively act on the "catalysts of change" (Adeolu 2008, 221).

Governance encompasses a variety of institutional dimensions, including: accountability; government effectiveness; rule of law; stability; and regulatory quality (WGI 2012). The governance pillars are essential to create effective institutional capacity for government management, and are often threatened in the presence of resource wealth. Accountability is an important aspect whereby public officials are held responsible for their actions and decisions. While intergovernmental oversight maybe one form of oversight, the public should have the capacity to hold their government accountable by vote and free association (WGI 2012). Transparency is an important aspect to guarantee accountability, by ensuring access to information (McFerson 2010, 338). The institution of government effectiveness ensures that public services are provided, quality and committed policies are implemented, and civil service is independent of political pressure and free of corruption (WGI 2012). Rule of law is the uniformity, perception, and quality of overall safety, application of social rules, and enforcement of laws (WGI 2012). Finally, regulatory quality is the government's ability to promote and foster economic and social development through sound policy creation and implementation (WGI 2012). These governance dimensions are necessary to create effective institutional capacity, but are threatened by governmental failures, such as corruption, misallocation of priorities, and ineffective policies, processes, and laws.

While governance issues need to be addressed to create a stable, legitimate, and effective government model, economic policies are equally important to combat the resource curse. Governments must determine how to best utilize resource revenues and develop effective financial management policies, to convert volatile and finite revenue streams into sustainable

economic growth with high social returns. Key to developing economic policies, however, is a strong bureaucratic structure that can effectively implement and manage resource revenues.

Chile has developed and changed its economic policies after experiencing a boom in its mining industry, to avoid the resource curse. The country has successfully managed its revenue and budget policies to ensure its other economic sectors remain competitive (World Bank 2009, 57-8). Likewise, the case of Botswana, as previously mentioned, shows the capacity of these effective domestic policies (Robinson 2009). The Botswana government saw the limitations and volatility of the mining industry, and maintained fiscally conservative budgets and policies. The government refused to run large budget deficits or incur large foreign debts. Instead, mining revenues were invested in human capital and infrastructure projects. Further, by devoting itself to reducing corruption and implementing sound and effective regulations and policies, the government was able to attract private and foreign investment. By maintaining a strict rule of law, coupled with sound financial management, procurement procedures were predictable and property rights were guaranteed. In contrast, Nigerian laws and policies are unpredictable. With ill-enforced and arbitrary accounting, procurement, and financial laws, investments were deterred (AEO Nigeria 2011, 6). Without stable and predictable laws, and an untrustworthy government, Nigeria has seen little growth, while Botswana has thrived.

### *Resources as a Financing Mechanism*

Even in poorly developed countries, resource wealth can be utilized as investment opportunities, by providing the financing mechanism to develop human capital, infrastructure, and economic sectors. In order to be successful, public investments must be scrutinized for the greatest social

impact and economic returns. Public investment decisions must be based on determining which investments would bring the greatest positive effects on poverty and economic growth (Wiebelt 2011, 746). The World Bank and IMF have worked to develop country reports to best accelerate growth and reduce poverty. However, the reports are often conflicting, stating that rural and agricultural investments are vital for development, yet paradoxically writing that urban development is most important to increasing markets and citizen mobilization (Wiebeit 2011, 746-7). Since urban areas are the product of population and industrial clustering, innovation and productivity can be enhanced if public investments are utilized to manage urban expansion, congestion, and lagging infrastructure. However, investments in rural regions have a greater affect on reducing poverty and inequality. Governments must determine if a regionally focused or more generalized investment approach will yield the most effective development. Regardless, resource wealth can have a positive impact on the economic growth and human development in a developing country.

## **Chapter Summary**

Given extensive research and commentary, there have been well-documented cases of general policy frameworks and solutions to avoid the resource curse. Successfully managing resource wealth is based on developing strong governance models and sound economic policies. A government must have the capacity to be responsive, and implement effective, predictable, and comprehensive policies. A fundamentally sound government has the institutional capacity to manage its finances. Careful consideration of public investments will determine how to best utilize resource revenues for maximum economic and human capital gains. While this section discussed general guidelines for resource management and policy frameworks, institutional

capacity can only be determined by looking at country specific conditionality; a “one size fits all” approach is not sufficient to determine specific policy recommendations (World Bank 2009, 31). The subsequent section will discuss Ghana’s political and economic constraints, to determine how to tailor generalized institutional guidelines into specific policy recommendations.

# Ghanaian Political and Economic Constraints

## Development Successes and Challenges

To understand the implications of oil revenue in Ghana, it is imperative to investigate the current economic factors, governmental institutional capacity, and infrastructure. Economically and politically, Ghana has been stable and successful over the past two decades. The country has experienced consistent economic growth, and remains one of the most stable democracies in the region. However, the country still has many developmental hurdles, including increasing human capital, expanding infrastructure, creating sustainable economic growth, and combatting inequality. Economically, despite promising economic growth rates, Ghana suffers from growing foreign indebtedness, high unemployment, and high inflation (AEO Ghana 2011). Ghana's oil revenue, if appropriately managed, can help alleviate these economic and developmental challenges. By examining Ghana's development success and challenges, a robust policy framework can be tailored to the country's needs and institutional gaps.

### *Economic Outlook*

Economically, Ghana is flourishing, and has been heralded as contemporary African success story (Obeng 2010, 85). As a result of economic reforms and structural adjustments during the 1990's, Ghana's GDP has grown by over 200% since 1985 (WDI 2012). Further, the country's GDP is projected to experience substantial and continued growth over the next few years (AEO Ghana 2011). Much of Ghana's success is attributed to its strict adherence to political liberalization, economic policy reform, promotion of human development, and its ability to synthesize development aid with national interests (Higgins 2009, 1). Foreign investors'



confidence is reinforced by Ghana's stable democratic and social environment, creating new financing partners (AEO Ghana 2012).

Ghana's economy is based in the agriculture industry, which accounts for 30% of its GDP (Wiebelt 2011, 748). However, the agricultural sector is predominantly invested in one crop, cocoa, whose dominance continues to grow each year, due to governmental support in the sector (AEO Ghana 2011). The government has bolstered the cocoa industry by creating high domestic prices, constructing roads in cocoa growing regions, and paying bonuses to cocoa farmers (AEO Ghana 2011). As deforestation occurs and farmland is converted to cocoa plantations, the industry threatens to crowd out other agricultural sectors, (AEO Ghana 2011). Further, Ghana's remaining economic composition lacks diversification. Nearly one-third of Ghana's GDP consists of gold mining, remittances, and official development assistance (ODA) (World Bank 2009, 11). Together, gold and cocoa constitutes over 60% of Ghana's total exports (Wiebelt 2011, 748). The country has not expanded downstream activities to manufacture and process cocoa and gold, resulting in a strict reliance on resource exploitation. As a result of this overreliance on two goods, and associated price volatility, Ghana has been diagnosed with symptoms of Dutch Disease (World Bank 2009, 45).

While the Ghanaian government has promoted cocoa exports, it just recently began to develop its private sector industries. The Ghanaian economic and development strategy has called for an improved investment climate and increased public sector expansion, yet faces many challenges (GSGDA 2010). In 2012, the World Bank ranked Ghana as 63rd of 183 in the ease of doing business, the strongest in West Africa (IFC 2012), which has led to strong increases in foreign

direct investment in services, telecommunications, construction, and industrial sectors (AEO Ghana 2011). In particular, India and China have emerged as strong economic partners, while investing in Ghana's infrastructure, trade, and communication sectors (AEO Ghana 2011).

While, the ease of doing business is strong for foreign direct investors, Ghana ranks amongst the world's worst in starting a business, dealing with construction permits, and resolving insolvency; it remains mid-level in the ease of paying taxes and cross-border trading (IFC 2012, 8). Additionally, access to credit remains low, and interest rates high, which has stifled domestic investment. Further, the Ghanaian government has increased taxes on domestic manufacturing sectors. Coupled with increased competition from foreign companies, the domestic manufacturing sector has a negative growth rate (AEO Ghana 2011), which the government needs to address.

While Ghana's exports have not increased substantially over time, with the advent of oil extraction, exports are expected to increase substantially over the coming decade (AEO Ghana 2011), which would lead to an appreciation of the real exchange rate. Such a measure would increase the domestic price of non-tradable goods and services (World Bank 2009, 11). As a result, imported goods, such as agricultural products, would become less expensive than domestically produced staples, leading to a substitution of purchased goods, a phenomenon that occurred during oil booms in Nigeria, Iran, Mexico, and Ecuador (World Bank 2009, 13). Such an exchange would have negative repercussions on the household welfare of export and commercial farmers, though subsistence farmers would remain unaffected, due to their insulation and isolation from commodity markets (World Bank 2009, 15). Further, general household

welfare would be negatively affected by price increases. Given the expected double-digit economic growth, inflation will be even more difficult to manage. Inflation is already an issue, as the current rate stands at 9% (AEO Ghana 2011).

Ghana's financial stability has recently been undermined by increased budget deficits (AEO Ghana 2011). Further, the government's inability to increase the tax effort has resulted in a large accumulation of payment arrears, which was estimated at 12% of GDP in 2010 (AEO Ghana 2011). With the government unable to honor its domestic payment obligations, delivery of social benefits suffer, and economic growth is unsupported (AEO Ghana 2011). In addition to domestic deficits, external debt remains an unresolved issue. In 2010, external debt rose by 29%, following onto a 15% increase in 2009 (AEO Ghana 2011). Overall, Ghana's external debt is equivalent to 68% of its GDP, and it is expected to increase further as the government contracts with foreign lenders for future development loans (AEO Ghana 2011). While oil revenues can offset these deficits, without sound policy reforms, the debt issue needs to be addressed in the long-term (World Bank 2009, 30). If left unchecked, budget deficits and foreign debts will further heighten future macroeconomic instability.

### *Sociopolitical Climate*

Although Ghana's economic performance is mixed, its sustained growth and policy reforms have translated to progress in its human development, and the country is on target to meet many of its Millennium Development Goals (MDG). Significant progress has been made to reduce child mortality, increase primary education enrollment, and halve the national poverty level by 2015 (UNDP 2010, 4). Official policy framework and goals, adopted in 2010 by the National

Development Planning Commission (NDPC) in its growth and development agenda, promotes the achievement of middle-income economic status by 2015. These policies are the result of the government's constitutional requirement to develop a sustainable economic and human development agenda that promotes a "just and free society," by giving Ghanaians the opportunity and right to live productive and meaningful lives (GSGDA 2010, 1).

Although Ghana is projected to achieve many of its targeted MDGs (UNDP 2010), the country still faces significant development challenges. Unemployment, poverty, and regional disparity are still significant, especially in the northern regions (Higgins 2009, 1). The Gini coefficient, a measured calculation of inequality in populations, is used to interpret the dispersion between incomes and levels of consumption (WDI 2012). Unemployment and underemployment are serious issues (AEO Ghana 2011), which have contributed to Ghana's inequality. Over the last twenty-five years, Ghana's Gini coefficient has increased, despite lower levels of poverty and increased economic growth (WDI 2012). The government must provide better educational quality and vocational trainings to promote job-related skills, especially for the informal economy's workforce (AEO Ghana 2011). Further conditions contribute to the country's inequality, including: regional disparity; rural versus urban populations; household size and demographics; and lack of access to health services, infrastructure, or quality education (Higgins 2009, 2).

Despite social inequalities, Ghana has managed to remain a politically stable, young democracy. The Ghanaian government is lauded for having: no lone dominant political party; parties who are well-institutionalized; governmental checks and balances that restrain executive leaders from

pursuing their own self-interests; and a relatively weak military (World Bank 2009, 27). As a result, Ghana's governance remains relatively strong, especially compared to its West African neighbors. World Governance Indicators (WGI), as indicated in Table 3, show Ghana's relative institutional capacity (WGI 2012). In terms of governance, Ghana ranks about average in the world, but its scores remain relatively modest. Without a strong position, the new oil revenues could negatively impact and reverse Ghana's institutional development. In addition, the World Bank has noted that, despite the high ranking of its governance indicators, Ghana "exhibits characteristics of a 'factional democracy'" (World Bank 2009, 27). As evidenced by the Ghanaian legislature's targeted expenditures, interest groups, clientelism, and patronage politics often incentivize politicians to spend on vested interests, instead of investing in public goods (World Bank 2009, 27). For example, in 2011, the government increased wages for public sector employees to establish a single pay range (AEO Ghana 2011; World Bank 2009, 27). While the process streamlined the old system, the wage bill is the highest in Africa and unequal in access; nearly 75% of the wage increases were limited to three departments and agencies: education, health, and local governments (AEO Ghana 2011). Instead of increasing public expenditures that better the quality of education, provide universal health services, or finance local infrastructure, the government's wage bill merely increased individuals' salaries, furthering socioeconomic inequalities (World Bank 2009, 27).

In addition to issues of inequality, Ghana's accountability mechanisms remain legally weak. While checks and balances exist between government entities, they remain underutilized (World Bank 2009, 28). A constitutional anomaly contradicts the ability for the minority parliamentary party to perform oversight on the executive office, who has little incentive to change the law

(World Bank 2009, 28). Further, the government possesses no Freedom of Information Act, which prevents public access to information (World Bank 2009, 28). In addition, with no entry point for civic engagement, citizens are largely non-participatory. Further, civil societies remain relatively weak, especially those representing non-oil sectors, providing no civic counterweight to government actions (World Bank 2009, 28). While the media is free, self-regulation and self-censorship remain a significant issue (World Bank 2009, 28). In addition, newspaper readership is low, while radio talk shows remain the most popular media outlet, which limits public access to information flows.

**Table 3:** Ghana's World Governance Indicators, Score and Rank

<b>Indicator</b>	<b>Governance Score</b> (-2.5 to +2.5)	<b>Percentile Rank</b> (0-100)
Voice and Accountability	+0.49	63.0
Political Stability/Absence of Violence	+0.04	47.6
Government Effectiveness	-0.01	55.5
Regulatory Quality	+0.09	54.1
Rule of Law	-0.07	54.0
Control of Corruption	+0.09	60.3

*Note:* Governance scores are on a scale of -2.5 to +2.5; higher scores correspond to better governance. Percentile ..... rank indicates Ghana's rank among all countries, with 0 as the lowest rank, and 100 as the highest.

*Source:* WGI 2012

As a result of this year's election, Ghana's political stability could be challenged, which would have negative repercussions on the country's socioeconomic stability. The last election cycle in 2008 saw a razor thin margin of .5% between the country's two major political parties, the New Patriotic and the National Democratic Congress parties (CDD 2009). Rhetoric between the two parties remains strong. While the electoral base is not ethnically split, both parties pander to social inequalities. The oil industry and associated revenues remain a politically charged topic in 2012 (Danquah 2012).

### *Infrastructure and Human Capital Challenges*

The Ghanaian government has taken a united front in its development policy framework to invest oil revenues into expanding its infrastructure. The lack of infrastructure has been one of the country's greatest development challenges (GSGDA 2010). Nearly 82% of the population does not have access to potable water, and 87% do not have access to sanitation (CIA 2012). As a result, cases of infectious diseases, including guinea worm and malaria, have increased, especially in rural areas (AEO Ghana 2011). In recent years, there has been a population exodus from remote rural areas to urban centers, creating congestion and slums, and further taxing urban power grids and sanitation (AEO Ghana 2011). Energy access and reliability also continue to be a key development issue.

The World Bank has analyzed Ghana's lack of infrastructure, its economic impact, and developmental needs over the next decade. In its study, the World Bank determine four key areas that are deficient in infrastructure: Information and Communication Technology (ICT), to provide mobile phone and broadband access; energy supply; transport and road networks, to give greater access to rural areas, and to decrease traffic density and congestion in urban areas; and water supply and sanitation (WSS) services (World Bank 2009, 41). In its calculations, the World Bank estimated an additional US\$1.6 billion would need to be invested annually to meet these infrastructure needs, 60% of which is direct capital expenditure and 40% for maintenance and operation of current structures. The breakdown is indicated in Table 4.

**Table 4: Infrastructure Spending Needs in Ghana**

<i>USD Expenditure per Year (Billions)</i>			
<b>Sector</b>	<b>Direct Capital</b>	<b>Operation and Maintenance</b>	<b>Total</b>
ICT	0.04	0.04	0.07
Power	0.60	0.13	0.73
Transport	0.27	0.22	0.49
WSS	0.11	0.20	0.31
<b>Total</b>	<b>1.02</b>	<b>0.58</b>	<b>1.60</b>

*Note:* Power Operation and Maintenance does not include fuel prices for energy generation

*Source:* World Bank 2009, 41; Africa Infrastructure Country Diagnostic

The World Bank estimates that Ghana currently invests approximately US\$1.1 billion annually in infrastructure. Therefore, the government of Ghana will need to invest an additional US\$1.6 billion to fully meet its projected needs (World Bank 2009, 41). Oil revenues can be utilized to finance infrastructure development. The World Bank estimates fully investing in infrastructure development would increase GDP growth by 4% annually (World Bank 2009, 40).

The most expensive infrastructural need is the energy supply, which is estimated to stunt GDP growth by .5% annually (World Bank 2009, 40). By alleviating the country's energy poverty, Ghana would create a better power supply and improve its productivity. Ghana remains relatively energy poor, with only 61% of the population having access to electricity in 2009 (WDI 2012), and 63% of energy consumption stemming from biomass (GSGDA 2010). In addition, rolling blackouts and power surges frequently interrupt urban regions' energy access throughout the day, which greatly impacts business productivity. The GSGDA has determined energy supply to be one of the most crucial areas of infrastructure need. In order to supply a secure energy network, however, the government must invest in creating greater access to



electricity grids, increasing the distribution of petroleum products, and improving the reliability for households and businesses (GSGDA 2010, 60). The oil industry could potentially resolve Ghana's energy poverty. Oil extraction produces natural gas, which is used to produce clean and efficient energy. However, to harness this potential, the government would need to invest in laying pipelines and processing facilities (World Bank 2009, 2).

## **Chapter Summary**

As the Ghanaian government attempts to address its developmental challenges, limited financial resources and availability restrict policy implementation and program development. However, with Ghana's recent discovery of oil, a new revenue source has been created. With this new potential, new risks arise. How Ghana decides to manage its oil reserves and subsequent revenue will determine whether its development policies and trajectories will progress. The projected revenue can have a positive or negative impact on the country's ability to develop, based upon the government's ability to manage these windfall gains. Still, Ghana faces many economic, institutional, and infrastructure challenges and constraints, including:

- A lack of diverse economic sectors, specifically underutilizing manufacturing industries,
- Domestic policies that create barriers for new business and private development,
- Symptoms of Dutch Disease, which will spread, due to increased revenue resulting from oil exports,
- Poor economic policies that increase budget deficits and foreign indebtedness,
- Lack of proper government accountability, due to a lack of transparency, institutions, and citizen participation,

- Inequalities between regions and income levels,
- Infrastructure issues, including WSS and rural transportation access, and,
- Decreased productivity due to energy poverty.

By taking into consideration these current socioeconomic and political opportunities and constraints, the following chapter will discuss policy recommendations to best utilize Ghana's resource revenues.

## **Policy Recommendations**

### **Tailoring a Policy Framework**

Despite the potential profits associated with resource wealth, many oil-producing countries have underperformed. In sub-Saharan Africa, resource wealthy countries, such as Angola, Equatorial Guinea, Gabon, and Nigeria have failed to develop their human capital or experience economic growth. This paradox can be attributed to these governments' lack of capacity to successfully manage its resource wealth, both through governance models and economic policies. By examining both successful and flawed management, general policy framework and strategies can be determined to effectively avoid the resource curse.

It is important to look at a variety of policy frameworks to determine which policies Ghana should adopt to successfully manage its oil revenue. Many resource wealthy and dependent countries have adopted a variety of policy solutions to avoid the resource curse, based upon recommendations from economists, international organizations, and other countries' models. However, a careful analysis must be conducted to understand all associated implications. For example, some economists propose direct payments to citizens, as a means to boost economic growth and encourage a sustainable economy (Mann 2009). According to the approach, the state would divide resource revenues, and give a direct cash deposit to its citizens (Mann 2009). As a result, the government creates a tax base, and allows citizens to be responsible for their own needs. Such programs have been implemented in Alaska. However, in many instances, direct cash supplements are utilized to purchase export-based goods, which can adversely affect an already precarious domestic economy. As a result, developing countries should focus on public

investments in infrastructure, instead of direct cash payments to its citizens, which exemplifies the need to tailor policies to country-specific situations.

The subsequent sections will discuss these policy solutions, and provide global examples of success and failure. The recommended policy framework and government strategies will be tailored to Ghana's current political and economic constraints, and carefully consider all subsequent implications.

### **Increasing Institutional Capacity and Better Governance**

Ghana must first address issues relating to its institutional capacity and governance models, to ensure the government has the capability to create, implement, and enforce policies. In particular, Ghana must focus on creating an effective administration, increasing transparency and accountability, and fostering civic participation.

#### *Policy Recommendation 1: Managing Effective Administration*

A separation of political and administrative powers over the management of extractive industries is necessary to promote independence and anticorruption. The “Norwegian Model” was developed in the 1970's as an administrative design for domestic extractive industries (Thurber 2011, 5366). The model is a division of administrative power between three independent government entities: a national oil company (NOC) provides the commercial activities and management of oil extraction; a ministry provides policies over the extractive industry and revenue management; and an independent regulatory body provides oversight (Thurber 2011, 5366). While the model has worked for resource wealthy countries, such as Canada, Norway,

Sweden, and the Netherlands, it has been less successful in Angola, Venezuela, Angola, and Nigeria (Thurber 2011, 5370). While governments may adopt management laws and institutions to increase efficiency, the absence of an implementing agent and lack of policy adherence threatens effectiveness. Anticorruption reforms may change perceptions, but do little by way of changing attitudes, tolerance, or demand for accountability, especially in the absence of an enforcement mechanism (McFerson 2010, 348). The success of the “Norwegian Model” is based on institutional capacity and political competition. Without either, administrative independence cannot be facilitated between the separate agents, until institutional capacity matures (Thurber 2011).

The Ghana National Petroleum Corporation (GNPC), the Ministry of Lands, and executive bodies administer Ghana’s oil reserves (Bryan 2007, 20). However, governmental ministers, by law, are able to sit on corporate boards. Ghana’s think-tank, the Center for Democratic Development (CDD) writes that the “the constitutional system of checks and balances is fatally undermined,” since legislative oversight might be curtailed by conflicts of interest in private business transactions (Bryan 2007, 27). Further, Ghana’s legislative auditors are financed by executive funds, impeding independent oversight (Bryan 2007, 30). The government should hire a legislative staff that has knowledge in managing extractive industry revenues, to provide expert recommendations in the oversight and management of resource finances (Bryan 2007, 69). In addition, Ghana must pursue an independent auditing and oversight body. Legislators should no longer be allowed to sit on corporate boards (Bryan 2007, 70). A legislative standard of ethics should be implemented, to encourage effective administration of oil revenue by encouraging independence and increasing transparency.

*Policy Recommendation 2: Sponsoring Transparency*

International campaigns, organizations, and actors have emerged to monitor, enforce, and implement independent review mechanisms to promote secure governance frameworks. In an effort to bolster transparency and accountability, the Extractive Industries Transparency Initiative (EITI) was founded in 2002, led by the UK Department for International Development (DFID) (McFerson 210, 347). Adopted by most African oil producing countries, EITI is a cooperative agreement between governments and extractive industries to report and publish payments associated with resources. By publishing company transactions to host governments, EITI reports provide greater transparency over the extractive industries (Di John 2011, 178). Still, the initiative does not resolve many underlying issues, such as accessibility, accountability, or regulatory quality. Despite transparent transactions, the initiative does not have the jurisdiction to determine *how* the reported payments should be spent, does not guarantee public access to the reports, and, thus, does not create accountability. Still, the initiative is a method to facilitate transparency in the extractive industry, but must be coupled with further institutional mechanisms.

Due to loose enforcement, lack of adherence, changing leadership, and national sovereignty issues, it is difficult to create and enforce meaningful policy changes outside of domestic legislatures (McFerson 210, 347). Ghana is a member of EITI, but its use is confined to industry-insiders (Bryan 2007, 70). As a result, the initiative is largely unknown, and its information and reports are underutilized (Bryan 2007, 70). The government, legislatures, and Mines and Energy Committee must become better oriented with EITI. Industry officials and the international

community can promote better access to EITI services. Better integration into the initiative can provide legislators with guidelines and standards for industry best practices on implementing codes of ethics and corporate social responsibility programs (World Bank 2009, 33). However, EITI is limited in scope if the government does not increase transparency in its expenditures. While revenues and payment information may be reported, *how* the government opts to spend revenues is not documented under the initiative. Therefore, for EITI to become comprehensive in transparency and accountability, it must also be paired with full government disclosure of information.

### *Policy Recommendation 3: Promoting Accountability*

In addition to using EITI to promote better transparency, the Ghanaian government should sponsor and adopt legislation that creates a Freedom of Information Act, as a means to promote transparency and accountability. Such an act would force governmental publication and disclosure of oil revenues and expenditure, as well as national tenders and procurements (World Bank 2009, vii). The World Bank has audited the Ghanaian government's budgets, and has discovered the documents are of "poor quality," diverge in actuals versus planned expenditures, and "inaccessibly written" (World Bank 2009, 28). Formalizing procedures for the government to disclose documents and information will likely increase accountability, and will ensure the government's subservience to citizens. However, for a Freedom of Information Act to succeed, the government must create the institutional capacity to respond to inquiries and requests, as well as promote the service. Additionally, civil society, advocacy networks, and individuals must utilize the act to actually perform governmental audits, and encourage social accountability.

*Policy Recommendation 4: Developing Civic Participation and Advocacy Networks*

In order for EITI and Freedom of Information Act to succeed, citizens must advocate and participate in social accountability. In Indonesia, strengthening civil society formed agrarian coalitions that were able to fight special interests, and reframe public priorities in underrepresented rural and farming communities (World Bank 2009, 30). Creating coalitions ensures all voices are heard in the debate, and creates a consensus on utilizing oil revenues (World Bank 2009, 30).

Current opinion of oil extraction in Ghana is bleak (Danquah 2012). Therefore, the national dialogue should increase. However, civil society and civic participation must be fostered first. Citizen participation in Ghana remains quite low, due to the lack of discourse and means. Further, civil societies in Ghana remain quite weak and unorganized, without contributing to public debates. These issues can be resolved by promoting participation, en masse. While newspaper readership remains low due to literacy rate, the government and advocacy groups can better target information and policy discussions to a broader and preferred media outlet, such as radio talk shows. The method has been successful with a business advocacy program, BUSAC, which has used various media outlets to successfully promote private sector support (BUSAC 2012).

While encouraging participation, attention should be given to organizing civil societies and various advocacy networks. Civil societies can promote better use of oil revenues, and rail against misuse of power and funds (World Bank 2009, 5). Non-oil sector interests are largely underrepresented or invisible to government networks and policy discussions. By organizing



these weak networks, such as manufacturing and agriculture sectors, better economic interests can be advocated on the national platform.

### **Creating Stable Economic Policies**

Once Ghana has the institutional capacity and governance to create and enforce sound policies, the government must focus on stabilizing the economy from the adverse effects of oil revenue. To do so, the government of Ghana should create a sovereign fund, promote new sectors and businesses, and restore economic sustainability.

#### *Policy Recommendation 5: Creating a Sovereign Wealth Fund*

In order to account for future revenues, many countries create sovereign wealth funds (SFW), which act as state-run investment funds for resource revenues. Resource revenues are invested in an SFW to contribute long-lasting returns for future generations, which accommodates a finite resource. Norway, Saudi Arabia, Kuwait, and the United Arab Emirates have the largest SFW's (Wiebelt 2011). However, these countries are already quite wealthy, and have effective government models to regulate such a fund. For developing countries, however, resources provide important financial revenues. These revenues may be better suited and have greater rates of return for immediate expenditure on domestic investments. Still, an SFW can be useful in regulating expenditures and smoothing price volatility (Wiebelt 2011; World Bank 2009). For example, a government can save a share of resource revenues in an external fund and then spend the remaining shares and accrued interest on domestic investments. Similarly, a government can account for price volatility by pegging the price of oil per barrel to a rate below anticipated market value for budgetary planning on expenditures; any excess revenue can then be diverted to an expenditure fund. By creating a blended economic framework, governments can account for

resource revenue instability and temptations, yet can still finance much needed domestic investments. São Tomé has created one of the most successful examples of an SFW in the developing world. São Tomé's oil fund is overseen by a variety of stakeholders, and is independent of executive appointments (World Bank 2009, 31). Parliament also holds annual meetings to review the fund's performance, and adjust policies as necessary (World Bank 2009, 32).

Currently, Ghana's oil revenues are deposited into a general treasury account, where they comeingle with other government funds (Bryan 2007, 30). Ghana should create an SWF in order to curb price volatility, and as a means to control real interest rate appreciation. Additionally, a sovereign fund would limit discretionary spending, which would provide a mechanism to curb corrupt practices. Oil revenue would be accounted in Ghana's budget, but a portion would be reserved for an SFW, while the remainder can be treated as income. However, since Ghana can utilize a large portion of oil income for needed development investments, only a minimal portion of revenues should be directed to an SFW. An analysis conducted by Manfred Wiebelt shows the best economic outcome would result in 30% of oil revenues being directed to an oil fund (Wiebelt 201). The resulting 70%, and interest, would be utilized for investment in all public infrastructure sectors. Utilizing an oil fund allows for continued income after the oil era, has an immediate impact on society, and promotes macroeconomic stability. The oil fund would insulate against price volatility, and, with less cash entering the economy, the real exchange rate would experience less appreciation, better promoting export vis-à-vis import growth (Wiebelt 2011, 762).

*Policy Recommendation 6: Facilitating New Business Sectors*

With the limited success of outsider-led “Washington Consensus” policy prescriptions, developing countries have taken a more active role in their own domestic development and financial management (Wiebelt 2011, 747). By taking an active role in adopting tailored economic policies, developing countries are able to direct public financing to key industries, as determined by the state’s greatest needs. Many developing countries, especially in sub-Saharan Africa, need to critically diversify their economic sectors. Such economic expansion can be led by greater investments in private-sector activities, increased public spending, mitigating inflation and real exchange rate appreciation, and attracting private investment (Wiebelt 2011, 748).

The Government of Ghana will need to counter the oil revenue’s impact on non-tradable industries, reduce the possibility of Dutch Disease, and promote long-term economic sustainability. To achieve these objectives, the government must remove barriers that hinder businesses from entering the formal business market (World Bank 2009, 17). The government must do a better job of promoting domestic manufacturing and construction industries. To promote construction, the government can collaborate through Private Public Partnerships (PPP) to finance infrastructure projects. By leverage PPP’s, the government will gain maximum financial capacity for projects that bring high social returns (World Bank, 2009, 17). Construction PPP’s will improve human capital, create jobs, and develop an underutilized economic sector.

Ghana has one of the lowest manufacturing productivity rates in the region, due to the lack of technology, education, and modernization (World Bank 2009, 46). Financial barriers prevent

manufacturers from investing in equipment and machinery (World Bank 2009, 47). To best promote the manufacturing sector, the government must grant better access to credit (World Bank 2009, 52). By providing credit, private sector manufacturers can better invest in human and physical capital. By investing in capital, manufactures can expand their businesses and boost productivity, strengthening this failing economic sector.

#### *Policy Recommendation 7: Restoring Economic Sustainability*

Ghana's high fiscal deficits and financial mismanagement threaten its macroeconomic stability. The government may be tempted to use the oil revenues to fund underperforming sectors, but such an action would only exacerbate the existing problems (World Bank 2009, 35). Without strengthening budgetary and financial management reforms, the potential gains will be lost (World Bank 2009, 35). The government cannot sustain on large budget deficits and foreign indebtedness, without adequate revenues. If using oil revenues as a means to placate failing policies, inevitable adjustments will only be prolonged. However, if the government were to enforce better discretionary budget control and financial planning, oil revenues can be used to fund useful projects and programs. The Ghanaian government must use oil revenues as a form of investments, to promote economic sustainability and better human development, instead of supporting failed and inefficient policies, programs, and industries.

#### **Investing Oil Revenues**

If the government of Ghana is able to create sound economic policies that promote sustainability and curtail the negative affects of windfall gains, it can utilize oil revenues as an investment in

infrastructure to further develop its human capital. The government should invest in its most needed structures: public works, rural infrastructure, and energy access.

*Policy Recommendation 8: Financing Public Works and Services*

Financing infrastructure can be one of the most productive investments in developing countries, both in rural and urban areas. Increasing physical capital, especially in roads and transport networks, can grant access to markets and cities, and enhance business and industry productivity (Wiebeit 2011, 747). By investing in rural infrastructure, regional household welfare increases, reducing rural poverty and inequality. In urban areas, productivity grows, as the ease of doing business is improved. Investments in public works, such as water and sanitation, can have wide-reaching benefits, including health and education. Infrastructure is not limited to physical capital, however. Further investments in telecommunications and human capital, such as education and vocational training, can further advance productivity and access (Wiebeit 2011, 747).

Oil revenues can be invested in much needed infrastructure projects, in an effort to finance the US\$1.6 billion needed annually to further develop Ghana's infrastructure. The funds can be used for capital development, and to increase the efficiency of existing infrastructure. In particular, further developing water and sanitation systems would have a great impact on human capital and economic development. Many of the MDGs are aligned with better health and education. By providing sanitary conditions and potable water, many health issues could be resolved (AICD 2010). By having a healthier population, more people are employable and productive, children are able to attend school, and overall quality of life is improved (AICD 2010). Further, by

promoting universal access to modern infrastructure services, regional inequalities and poverty can be reduced. In particular, rural areas and urban slums are in need of infrastructure development and improvement, respectively (AICD 2010). Given the social and economic benefits associated with water supply and sanitation development, oil revenues should finance public works and services projects. While infrastructure investment can have far-reaching impact, it needs to be targeted to regional and community needs (Wiebeit 2011, 747).

*Policy Recommendation 9: Focusing on Rural and Agrarian Infrastructure*

Public investments must be critically examined to maximize a policy's impact. In Uganda, public investment in the capital city of Kampala accelerated economic growth, but that growth was limited to the region, due to weak migratory and market links (Wiebeit 2011, 747). Evidence suggests there must be greater investment in lagging regions, rather than leading regions, to maximize poverty reduction and lessen inequality (Wiebeit 2011, 764; World Bank 2009, 40).

Ghana's commercial agricultural sector will likely be the most affected by oil revenues. Since this has the greatest economic footprint, and given the high pro-poor and social impact of the sector, the government needs to focus on how to best compensate for oil revenues' negative externalities. However, the government should not subsidize agriculture or farming, since such measures would not create sustainable economic impact (Wiebelt 2011, 763). Instead, by financing public service projects, such as roads, water and sanitation, power, and irrigation, Ghana's poorest will experience the greatest long-term and sustainable economic impact (World Bank 2009, 13). In addition, investing a portion of oil revenue in rural areas and agricultural infrastructure will further decrease direct cash injections into the economy, offsetting the

appreciation of the real exchange rate (World Bank 2009, 13). The impact of financing rural infrastructure, as well as smoothing the real exchange rate, will keep inflation low and exports competitive, helping export farmers and domestic consumers (World Bank 2009, 14-5).

#### *Policy Recommendation 10: Increasing Energy Access*

The potential gas reserves associated with the oil fields provide an important source of electricity production, and can increase energy access. By financing the laying of a gas pipeline and processing facilities, the World Bank estimates that 20-30 thousand jobs would be created with project inception, with an additional 25-35 thousand jobs at full capacity by 2015 (World Bank 2009, 3). Currently, oil is the predominant source of electricity production in Ghana, although gas-produced electricity is less expensive than oil. Therefore, by switching to gas production, the savings would be passed to the consumer. Despite an increase in electricity output, the impact would be limited to the current electrical network. In order to have farther-reaching effects, the government would have to increase the electricity grid's capacity and coverage. While the annual cost, as previously indicated, is estimated at US\$600 million per year, the venture would create jobs, increase productivity, and grow GDP.

### **Chapter Summary**

General policy frameworks can give guidance on oil revenue management, but it is essential to tailor specific policies to Ghana's strengths and weaknesses. By examining Ghana's political constraints, economic limitations, and infrastructure gaps, policies can be developed to increase institutional capacity, develop sustainable economic growth, and invest in public works. Resource revenues often create great challenges in developing countries. However, if Ghana

adopts policies that create effective governance, these revenues can be used for economic development and domestic financial investments. Box 4, on the next page, outlines policy recommendations that will increase institutional capacity, promote sustainable economic practices, and provide the best investment options.



**Box 3: Policy Recommendations****INCREASING INSTITUTIONAL CAPACITY AND BETTER GOVERNANCE*****Policy Recommendation 1: Managing Effective Administration***

- Hiring experts, to advise legislators on extractive policies
- Excluding legislators from occupying corporate boards, to discourage conflicts of interest

***Policy Recommendation 2: Sponsoring Transparency***

- Better integrating the government and industry with EITI practices, to increase awareness and outreach

***Policy Recommendation 3: Increasing Accountability***

- Passing a Freedom of Information Act, to publically disclose government revenues, expenditures, and tenders
- Ensuring institutional capacity to address information requests, to guarantee the Freedom of Information Act is a functional tool

***Policy Recommendation 4: Developing Civic Participation and Advocacy Networks***

- Promoting organization of civil societies, to utilize accountability measures, scrutinize government actions, and promote underrepresented economic sectors

**PROMOTING STABLE ECONOMIC POLICIES*****Policy Recommendation 5: Creating an SWF***

- Utilizing only a portion of revenues and investing the rest, to insulate against price volatility, and restrict the appreciation of real exchange rates

***Policy Recommendation 6: Facilitating New Business Sectors***

- Increasing access to capital, to encourage growth in underutilized manufacturing and construction sectors
- Leveraging PPP's, to create projects that promote private sector growth with high social returns

***Policy Recommendation 7: Restoring Economic Sustainability***

- Strengthening budgetary and financial management reforms, to restrict high budget deficits and vested interests

**INVESTING OIL REVENUES*****Policy Recommendation 8: Financing Public Works Sectors***

- Financing infrastructure projects that create better access to water services and sanitation, to promote human development

***Policy Recommendation 9: Focusing on Rural and Agrarian Infrastructure***

- Financing rural infrastructure, to support areas most likely impacted by oil revenues, and limiting the effects of Dutch Disease

***Policy Recommendation 10: Increasing Energy Access***

- Investing in gas pipelines, to utilize oil extractive byproducts for electricity production
- Increasing electricity coverage and capacity, to increase productivity and create jobs

## Conclusion

Developing countries often view resource wealth as a financial stimulant, promoting human development and economic growth. However, studies suggest the opposite is true – resource wealth often creates conflict, corruption, low economic output, and low human development. The paradox has become known as the ‘resource curse.’ Still, resources, as a commodity, cannot be a causal mechanism. Instead, *how* a country manages its resource wealth can determine success or failure. In order to create effective policy recommendations to increase institutional capacity and economic sustainability, political and economic stakeholders must carefully examine country specific opportunities, needs, and constraints, and then tailor the reforms as needed. This policy report attempts to examine Ghana’s recent oil discoveries and associated economic and development implications. The policy recommendations developed in this report provide a framework on how Ghana can avoid the resource curse, and instead use oil revenues to promote human development.

Ghana has emerged as a developmental success story. After decades of low economic growth and political uncertainty, the country has recently become one of the most stable democracies in the region. Ghana is projected to become a middle-income country through its economic and human capital expansion. However, the country still experiences many development challenges: mired institutional capabilities, social and regional inequality, unsustainable economic policies, and poor infrastructure. With the advent of its oil discovery and extraction, Ghana is now in a position to utilize its export revenues as a catalyst of change.

In order for Ghana to best utilize its resource wealth, the government must ensure it has the institutional capability to manage its oil revenues. The government must create a policy framework that promotes effective administration of oil funds, sponsors transparency, and increases accountability. In return, Ghanaian citizens must advocate civic participation to enforce social accountability. Once the government has created an effective governance model, it can implement stable economic policies that combat the negative externalities often associated with windfall gains. To create a sustainable economy, the government must promote prudent economic policies that develop underrepresented economic sectors, and advocate fiscal independence. Finally, to promote development, the government can utilize its resource wealth to finance infrastructure investments. In particular, the government should invest in public works, energy platforms, and rural infrastructure, to increase productivity and underscore the greatest rates of social returns.

Obviously the policies recommended in this report only highlight the greatest institutional gaps and development needs. The government will need to collaboratively work across agencies, departments, and political parties, to develop comprehensive institutional and economic policies. Each policy recommendation will need further analysis to determine the most effective implementation strategy. This report merely attempts to produce public discourse, and highlight Ghana's development needs and possibilities. Resource wealth does not necessarily need to be a 'curse,' but can provide opportunity, potentials, and optimism. How Ghana decides to reform its institutions and manage its resource wealth will determine whether it succumbs to the resource curse, or succeeds in promoting its development, its future and, its people.

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