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# **Future Oil Revenues and Political Dynamics in West and East Africa: A Slippery Slope?**

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**South African Institute of International Affairs**

African Perspectives. Global Insights.

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## **ABSTRACT**

This paper attempts to model the likely interaction between political dynamics and windfall oil rents in a number of soon-to-be oil-dependent economies in Africa. Using a theoretical framework designed by North, Wallis and Weingast, and a game theoretic model developed by Robert Bates, it examines the potential impact of these rents in four countries, namely Ghana, Liberia, Uganda and Tanzania, conditioned on the nature of the current political equilibrium. Only when these dynamics are properly understood can credible policies be designed to overcome the difficulties normally associated with oil dependence. The paper finds that the nominal existence of democracy is by itself insufficient to propel countries towards economic dynamism and meaningful political inclusion. Only in instances where ratios of oil rent to government revenue are low and existing institutions relatively strong is equilibrium political stability likely to be maintained. In almost all instances, oil rents disrupt political incentives in a way that is likely to undermine economic performance. Ghana is a potential exception but the bulge of youth unemployment and relatively limited access to economic opportunities outside the extractive industries remain a cause for concern. In the light of these findings, policy practitioners should aim to design policies for oil rent management that understand political equilibria and neither disrupt these equilibria towards instability in the short run nor entrench a predatory elite over the long run.

## **ABOUT THE AUTHOR**

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## ABBREVIATIONS AND ACRONYMS

GDP	gross domestic product
GEMAP	Governance and Economic Management Assistance Programme
GNPC	Ghana National Petroleum Company
LAO	limited access orders
NDC	National Democratic Congress
NPP	New Patriotic Party
NRM	National Resistance Movement
NWW	Douglass North, John Wallis and Barry Weingast
OAO	open access orders
PSA	production sharing agreements
UCT	University of Cape Town

## INTRODUCTION

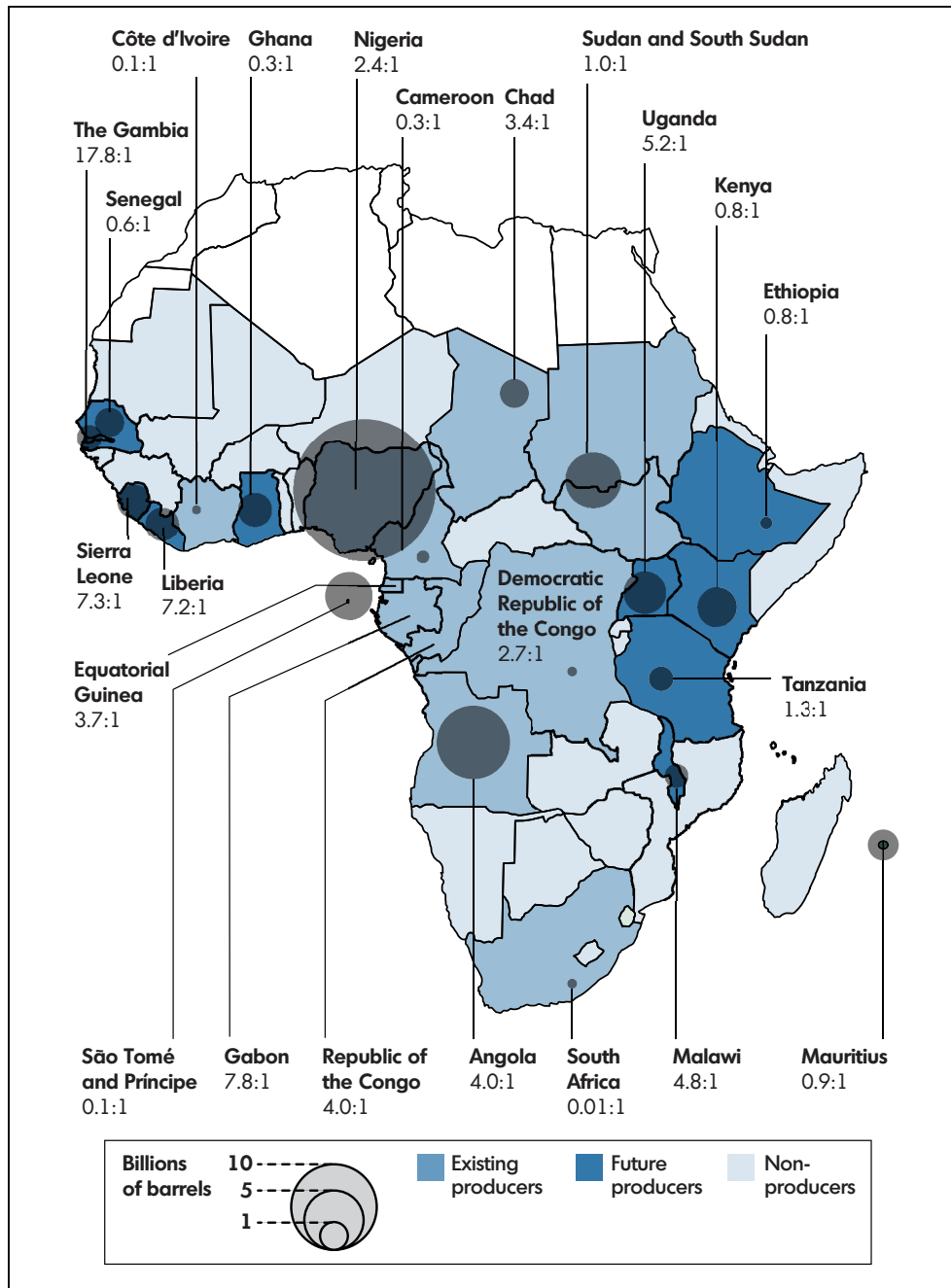
A recent article by Larry Diamond and Jack Mosbacher in *Foreign Affairs*<sup>1</sup> boldly proclaimed an impending curse for African countries about to become oil-wealthy. Given the gloomy prospects for proficient oil revenue management in predominantly authoritarian African states, the authors recommended an improved version of the ‘cash-to-citizen’ model as a policy intervention to overcome the probable negative effects on governance associated with oil windfall revenues. Governments would then tax the transfer, bypassing the problems normally associated with decreased taxation when oil rents enter the political economy equation. The primary problem with the recommendation is its implicit assumption that domestic political dynamics do not necessarily impose a binding constraint, though there is increasing consensus in the development economics literature that good economics is not easily transposed into good politics.<sup>2</sup> This paper therefore attempts to model the likely interaction between political dynamics and windfall oil rents in a number of soon-to-be oil-dependent countries. It examines the potential impact of these rents in four select countries, conditioned on the nature of the current political equilibrium. Only when these dynamics are properly understood can credible policies be designed to overcome the curse.

The paper begins with an overview of the economic geography of projected oil dependence in Africa, concentrated in the Gulf of Guinea and the Rift Valley respectively. Second, it briefly reviews the literature that attempts to understand why oil wealth often fails to produce sustainable development. Third, it explores a theoretical framework for selecting country cases, and an associated game theoretic model appropriate for analysing the likely impact of oil wealth on political stability and development in the selected countries. Following case analysis, it concludes by critiquing the cash-to-citizen proposition, recommending incremental reform instead. Policy initiatives must be incentive-compatible with the existing distribution of de facto power and the nature of the elite bargain in host countries if they are to be successful.

## AFRICA’S PROJECTED OIL BOOM

Over the next decade, at least 12 African nations will become major oil exporters. Projections indicate that more than 25 billion barrels of oil reserves exist in the Gulf of Guinea and the Rift Valley, recoverable largely as a function of improved exploration and extraction technologies. Figure 1 shows both the relative size of these reserves and the projected oil revenue dependency ratios, measured as rents to domestic taxation revenues.

**Figure 1: Oil reserves and ratios of oil revenues to tax revenues for current and future exporters in sub-Saharan Africa**



Note: The ratios of oil revenues to tax revenues are derived from comparisons of aggregate national tax revenues (using World Bank data) and projections of oil revenues based on estimated reserves, projected export capacity and estimated future oil prices.

Source: Diamond L & J Mosbacher, 'Petroleum to the people: Africa's coming resource curse and how to avoid it', *Foreign Affairs*, 92, 5, September/October 2013, <http://www.foreignaffairs.com/articles/139647/larry-diamond-and-jack-mosbacher/petroleum-to-the-people>.

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Among West Africa's emerging oil producers, São Tomé and Príncipe has the highest reserve estimate at 4 billion barrels, followed by 2 billion in Ghana, 1.5 billion each in Senegal and Liberia, and 1 billion in the Gambia respectively. In East Africa, estimates suggest 3.5 billion barrels in Uganda, and up to 3 billion each in Kenya and Tanzania. The economic and fiscal implications of this future wealth are difficult to overstate:<sup>3</sup>

At current prices, the new sources of oil and gas could inject close to \$3 trillion into the economies of some of Africa's poorest and least developed nations. [...] The total [sic]<sup>4</sup> annual [gross domestic product] GDP of the 12 future exporters in 2011 was \$181 billion. If \$3 trillion flows to these countries from oil over a period of 30 to 50 years, then the total annual increase in economic output would amount to \$60 billion to \$100 billion – an increase of over one-third. [...] For every \$1 that the 12 future [major] exporters<sup>5</sup> currently receive from taxation, an additional \$1.50 is received from foreign aid. [...] The median ratio of external rents to domestic taxation is expected to increase by a multiple of nearly five, from just over 1:1 to nearly 5:1.

The authors further note that these 'future exporting' countries outperform current exporters on governance indicators by some margin. It is important to note at the outset that two of these countries, Ghana<sup>6</sup> and Uganda<sup>7</sup>, are, in fact, already producing oil but cannot as yet be classified as 'major exporters'. Mosbacher and Diamond predict that unless a new approach to governance of oil revenue is attempted, this windfall wealth will 'drag the future exporters down to the miserable governance levels of the current exporters'.<sup>8</sup> External rents cause distortions to a state's incentive structure because they remove the material need for governments to impose taxes, one of the few means of attaining and maintaining citizen–state accountability.<sup>9</sup>

## THE PARADOX OF PLENTY AND THE PERILS OF UNEARNED INCOME

There is now a vast literature that attempts to assess whether natural resource endowments constitute a development 'curse'. The best recent review assesses eight channels through which the hypothesised inverse relationship between resource wealth and development operates.<sup>10</sup> While it focuses primarily on negative savings and the effects of commodity price volatility, it recognises the move towards a consensus that the quality of institutions is of ultimate importance in determining the likely development impact of natural resource wealth. The best research also emphasises, however, the importance of distinguishing the differential impacts of different types of resources. The literature below therefore deals exclusively with the effects of oil rents on development.

In 1999 Terry Lynn Karl, author of *Paradox of Plenty*,<sup>11</sup> reflected that 25 years after the oil price boom of the 1970s most oil-exporting countries were in crisis, especially capital-deficient ones, '[p]lagued by bottlenecks and breakdowns in production, capital flight, drastic declines in efficiency, double-digit inflation, overvalued currencies and budget deficits',<sup>12</sup> which undermined export competitiveness in the manufacturing sectors. The high hopes of development that had infused the formation of the Organization for Petroleum Exporting Countries in the 1970s were dashed. Political stability suffered as a result.

By 2013 Diamond and Mosbacher noted that not a single African country had been able to keep oil money from being captured by a small elite:<sup>13</sup>

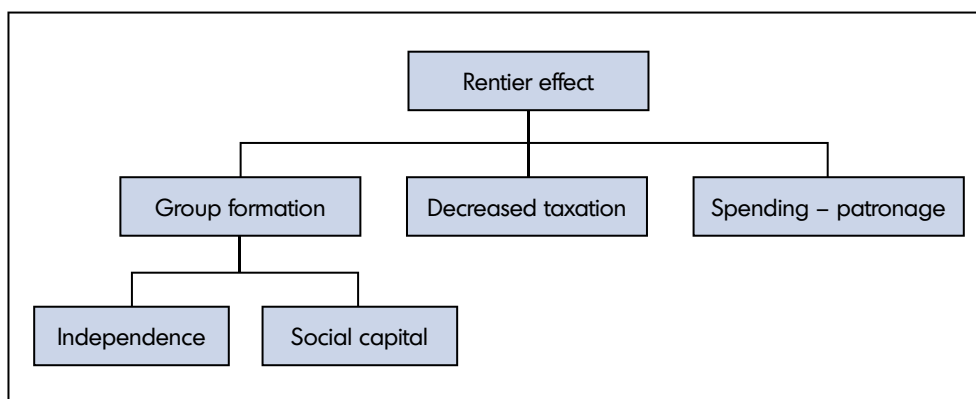
Every one of the 12 current oil exporters currently falls into the bottom half of the UN's Human Development Index (HDI). According to the World Bank, more than a tenth of all children born in oil-rich African countries die before the age of 5, double the global average.

Why the adverse outcomes from wealth that holds developmental promise?

Given the importance of political institutions for determining a nation's development prospects,<sup>14</sup> the most compelling explanations are those that focus on how oil wealth affects political dynamics. In 2001 Michael Ross<sup>15</sup> examined the impact of oil wealth on democracy using cross-country regressions to test three causal mechanisms that had previously been hypothesised in the literature. These are examined below.

### Rentier effect

**Figure 2: The rentier effect**



Source: Author's own compilation.

As demonstrated in Figure 2, the 'rentier effect' is expected to hinder democracy through three channels.<sup>16</sup> Taxation is an important means of representation for citizens, forging citizen–state accountability that would otherwise be absent.<sup>17</sup> When governments derive sufficient revenue from oil deals, the hypothesis suggests that they will tax their populations less heavily, severing the accountability link. This is the hypothesis from which Diamond and Mosbacher are working when they promote cash transfers to citizens that government can then tax. Bates offers a more realistic view, wherein taxation is less about representation than it is about providing sufficient revenue for governments to overcome the incentive to engage in predation.<sup>18</sup>

A second aspect of the so-called rentier effect suggests that oil revenue is spent on extending patronage, which inhibits latent pressure for democratisation or increases incumbents' re-election probability in weak democracies. Recipients of state largesse or



public sector jobs have a diminished appetite for incurring the cost of fighting for political reform in the direction of democracy. Robinson, Verdier and Torvik conclude that<sup>19</sup>

resources tend to be over-extracted by politicians because they discount the future by the probability they remain in power. Second, permanent resource booms, because they increase the value of being in power, lead politicians to allocate more resources to staying in power. As a result they tend to discount the future less and this leads to more efficient resource extraction. The fact that booms increase the probability of staying in power tends to counteract the inefficiency stemming from the fact that politicians discount the future too much. Third, we showed that despite this optimistic result, resource booms tend to create inefficiency in the rest of the economy because they encourage politicians to engage in inefficient redistribution to influence elections. However, the extent to which this phenomenon actually leads to a resource curse (which we defined as a situation where a resource boom leads to lower GDP) depends on the quality of institutions. In countries with institutions which limit the ability of politicians to use clientelism to bias elections, resource booms tend to raise national income. When such institutions are absent, perverse political incentives may dominate and income can fall – there is a resource curse.

A final element of the rentier effect concerns group formation. Resembling the previous argument in some ways, it suggests that governments distribute rents in such a way as to prevent the formation of social groups that are economically and politically independent from the state. Independent groups tend to demand political autonomy, an inconvenience that elites prefer to avoid. In the same way, elites have a distinct interest in retaining power through preventing the formation of social capital through civic groups not affiliated to the state.

### **Repression effect**

Ross writes that '[c]itizens in resource-rich states may want democracy as much as citizens elsewhere, but resource wealth may allow their governments to spend more on internal security and so block the population's democratic aspirations'.<sup>20</sup> Incumbent elites tend to find it less costly to repress demand for political reform than to democratise or, in weak or weakly emerging democracies, the state may find it expedient to build internal military strength to provide the necessary coercion around election time. This is only necessary where vote rigging is unsuccessful. Furthermore, some of the more nuanced 'resource curse' literature attempts to understand the role of ethnic fragmentation in why resource wealth tends to produce adverse outcomes. It suggests that incipient ethnic conflict drives government to increase the size of the military to impede revolt. This also reduces the probability of reforming towards democracy.<sup>21</sup>

### **Lack of modernisation effect**

Rooted in modernisation theory, this hypothesis suggests that oil wealth inhibits a number of progressions which tend to undergird transitions to democracy. First, increased

education levels provide a foundation for articulating preferences for political reform.<sup>22</sup> Better-educated populations are better equipped to organise and communicate. Second, occupational specialisation produces a 'more autonomous workforce, accustomed to thinking for themselves on the job and having specialised skills that enhance their bargaining power against elites'.<sup>23</sup> Resource-led growth tends to undermine these developments. Incumbents have little incentive to provide high-quality education that might equip the population to demand political reform. In economic terms, resource-led growth tends to undermine occupational specialisation as a strong currency undermines the competitiveness of other export sectors, especially manufacturing. This is a variant of the 'Dutch disease' arguments common in the literature. Together, these arguments suggest that oil wealth is likely to inhibit the development of political institutions that could provide a platform for sustained economic development.

### Debates surrounding the literature

Ross concludes, after employing a generalised least-squares method with a pooled time-series cross-national dataset, that both oil and mineral resources (as a proportion of GDP) have strong anti-democratic effects.<sup>24</sup> Counter-intuitively, though, he finds that 'barrel for barrel, oil harms democracy more in oil-poor countries than in oil-rich ones'.<sup>25</sup> Testing for each proposed causal mechanism, Ross finds strong evidence for the rentier effect, in that 'higher personal and corporate taxes are strongly associated with more democratic government'.<sup>26</sup> Moreover, the spending effect is in evidence and has a more lasting duration than the taxation effect: 'the larger the government, the less movement toward democracy over the following five years'.<sup>27</sup> On the repression effect, Ross finds that ethnic tension is not significantly associated with increased military expenditures.<sup>28</sup> However, oil exports are positively and significantly associated in general with increased military spending.<sup>29</sup> The exact reason is not apparent from the regressions. With regard to modernisation theory, the regressions indicate that occupational specialisation is positively and significantly associated with democracy. However, 'the evidence that oil and mineral wealth influence occupational specialisation, is somewhat weak'.<sup>30</sup> Modernisation and spending effects may occur simultaneously. Government can subsidise education and other services without a concomitant growth in the manufacturing and services sector. Reform is thus hindered by limited economic opportunity and governments' propensity to stifle political dissent. The overall result, Ross argues, is that the 'three effects may interact in pernicious ways, creating a "resource-trap"'.<sup>31</sup>

Stephen Haber and Victor Menaldo critique Ross's work on the grounds that extant cross-country regressions assume random effects and are run on panel datasets with relatively short time dimensions.<sup>32</sup> Natural resource reliance is not an exogenous variable, rendering cross-country regressions an inadequate strategy for establishing causation. Omitted variable bias may drive the results through unobserved country-specific and time-invariant heterogeneity. The authors developed more historically distant datasets and employed time-series-centric techniques to test whether there is, in fact, a relationship between resource reliance and regime type within countries. They found that, both on a country-by-country basis and across several different panels, increases in resource reliance are not associated with authoritarianism. In fact, Haber and Menaldo go so far as to suggest that in many specifications, their results suggest a conditional 'resource blessing'.<sup>33</sup>

In response, Jorgen Juel Andersen and Ross show<sup>34</sup>

that they [Haber and Menaldo] might be correct for the period before the 1970s, but since about 1980 there has been a pronounced resource curse. [...] The powerful anti-democratic effects of oil since the late 1970s are hence obscured by the weaker relationship between oil and democracy in the 1800–1975 period. [...] We also show that when oil income is allowed to affect regime types over three, five, or seven years, rather than a single year, these anti-democratic effects become much larger and emerge earlier.

Haber and Menaldo argue that because most oil-wealthy countries have become more democratic over time, there is no resource curse.<sup>35</sup> Andersen and Ross point out that valid inference requires an examination not only of the ‘treatment’ group but also of a comparable ‘control’ group.<sup>36</sup> While Haber and Menaldo suggest that oil-wealthy countries have grown slightly more democratic over time, the point remains that they made far slower progress towards democracy than the non-oil states (the ‘control’ group).<sup>37</sup> Finally, the argument that the oil curse is time-specific does not render the causal inference invalid, as many relationships of interest in political economy are, in fact, time-specific.

A forward-looking set of comparable country-specific examinations is now necessary.

## THEORETICAL FRAMEWORK AND CASE SELECTION

Theoretically, this paper follows an institution-centred framework developed by Douglass North, John Wallis and Barry Weingast (hereinafter referred to as NWW).<sup>38</sup> The central concept is an elite bargain – the agreement struck between elites to maintain the dominant coalition. In developing countries, elites establish means of rent generation and distribution through manipulating economic and political institutions to exclude non-elites by design. This set of institutions characterises developing countries as limited access orders (LAOs). Elites ensure that rents are allocated in such a way as to reduce the probability of violence by non-elites or even within the elite formation, as violence erodes the available rent pool. The rules of the game – the definition of institutions – are generally personalised, distinguishing developing countries from open access orders (OAOs), where credible commitment to honouring private investment is built into impersonalised and predictable rules. In OAOs, citizens’ close relations with elites (or absence thereof) do not determine access to political and economic opportunity. LAOs can be disaggregated further along a continuum from ‘fragile’ to ‘basic’ to ‘mature’.<sup>39</sup> The distinction between OAOs and LAOs transcends the notion of democracy versus non-democracy. This is analytically more insightful, given that in many contexts democracy is a reflection of patronage loyalty as opposed to an indication of genuine political preference.

In the World Bank’s study of natural resource-led development,<sup>40</sup> the concept of an LAO is essentially disaggregated into a quadrant, undergirded by the LAO continuum and depicted in Table 1.

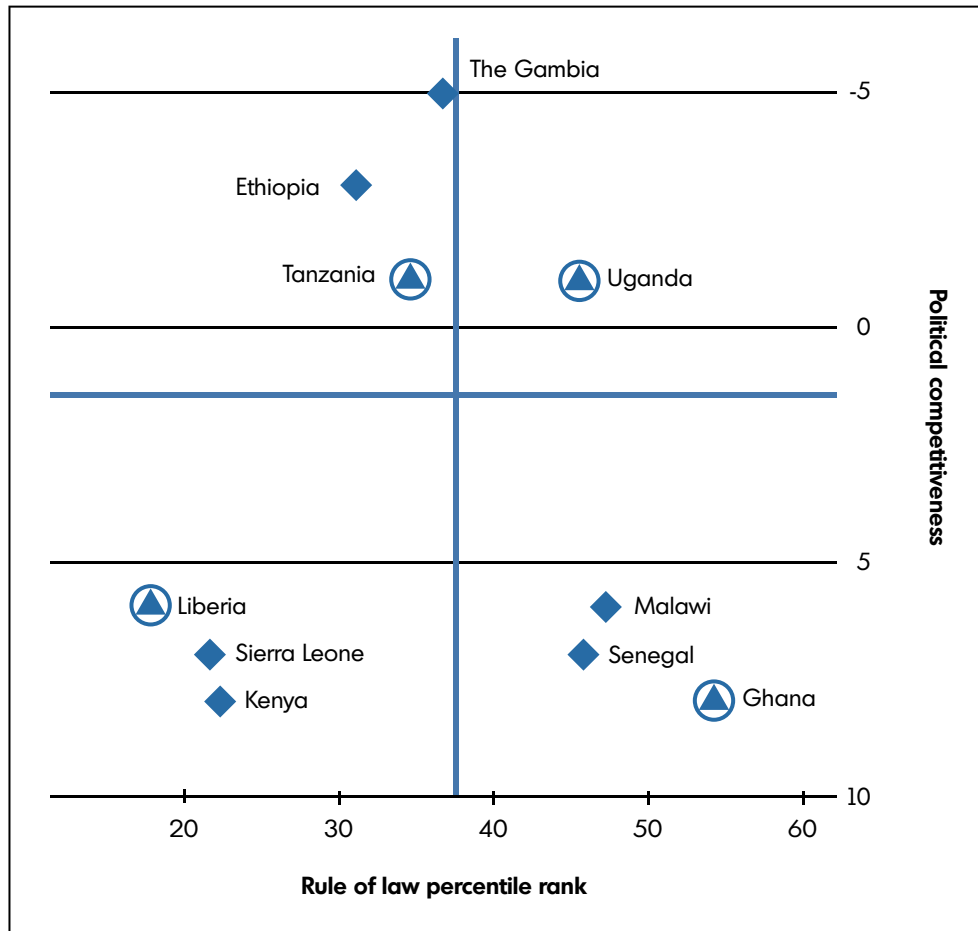
**Table 1: Political economy contexts and upstream dynamics**

Political inclusiveness	Credibility of intertemporal commitment	
	Less credible/weaker enforcement	More credible/stronger enforcement
Less inclusive/ less collectively orientated	<p><b>Patrimonial rule:</b></p> <p>Individualised political authority; crony hierarchy; few restraints on power.</p> <ul style="list-style-type: none"> <li>• Extremely low predictability; high risk to contractual stability</li> <li>• Extreme time inconsistency – obsolescing bargain acute</li> <li>• High private rent-seeking, more arbitrary.</li> </ul>	<p><b>Hegemonic government:</b></p> <p>Institutionalised one-party regime; either predatory or benevolent.</p> <ul style="list-style-type: none"> <li>• Moderate predictability; lower risk to contractual stability</li> <li>• More time consistency – obsolescing bargain managed</li> <li>• High private rent-seeking, more institutionalised.</li> </ul>
More inclusive/ more collectively orientated	<p><b>Clientelist pluralism:</b></p> <p>Political competition based on extensive use of clientelism/ patronage.</p> <ul style="list-style-type: none"> <li>• Low predictability; some risk to contractual stability</li> <li>• High time inconsistency – obsolescing bargain acute</li> <li>• Less private rent-seeking (some political side payments).</li> </ul>	<p><b>Programmatic pluralism:</b></p> <p>Electoral competition based on programmes; horizontal and vertical accountability.</p> <ul style="list-style-type: none"> <li>• Higher predictability; little risk to contractual stability</li> <li>• More time consistency – obsolescing bargain managed</li> <li>• Less private rent-seeking; emphasis on rent-sharing.</li> </ul>

Source: Barma N, Kaiser K & TM Le (eds), 'Extracting resource wealth: The political economy of sector organisation', *Rents to Riches? The Political Economy of Natural Resource-Led Development*. Washington: World Bank, 2012, p. 100. (layout adapted by author)

For this paper, one country from each quadrant in Figure 3 is chosen for the sake of establishing the likely impact of future oil revenues on the elite bargain in selected oil-wealthy countries. As a proxy for inclusiveness (the vertical axis), the Polity IV database provides a measure of a country's democratic competitiveness. The higher the polity score, the more competitive the electoral landscape. On the horizontal axis, the World Bank's governance measure, 'rule of law', is the relevant proxy; again, the higher the score, the stronger the level of inter-temporal commitment. Conditioned on future oil wealth dependence<sup>41</sup> and, for the sake of pairwise comparison, two countries are selected from West Africa and two from East Africa.

Figure 3: Case selection of future major oil-exporting countries in Africa



Source: Author's own compilation using data from the World Bank Worldwide Governance Indicators, databank, <http://databank.worldbank.org/data/views/variableselection/selectvariables.aspx?source=worldwide-governance-indicators>, accessed 13 December 2013; and the Polity IV Project 2012, database, <http://www.systemicpeace.org/inscr/inscr.htm>, accessed 13 December 2013

In the top-left quadrant, Tanzania is chosen. Its Polity IV score indicates that it is politically authoritarian (-1), with a relatively weak score among the candidates for rule of law (34.6%). In the top right quadrant, also in East Africa, is Uganda. Its Polity IV score is also -1 but its rule of law is relatively stronger at 45.5. In the lower half, Liberia is selected for the bottom left quadrant, with a Polity IV score of 6, and rule of law at 18. Ghana completes the selection with a Polity IV score of 8, and rule of law at 54, one of the strongest in sub-Saharan Africa.

Too many governance initiatives assume that the rule of law exists and seek to harness it. In most developing countries, however, the rule of law is a figment of the West's imagination. Scholars Jones-Luong and Weinthal put it this way:<sup>42</sup>

Political scientists and economists not only share the assumption that the revenue generated from mineral resource exports accumulates directly to the state, they also appear to have

reached a consensus that weak institutions are the crucial link between resource wealth and the countless negative economic and political outcomes attributed to it. Thus, they focus on solutions that aim to make the state a better 'manager' of these proceeds. Yet, ironically, these solutions require the existence of strong fiscal and regulatory institutions or effective external monitoring rather than aiming to promote the development of strong institutions in mineral-rich states.

Understanding why the rule of law is invariably weak is indispensable for crafting policy solutions that gain traction. A 2014 paper by political scientists Gillian Hadfield and Barry Weingast<sup>43</sup> tackles the question of what microfoundations contribute to establishing the rule of law: 'Despite its centrality to many literatures, the concept of the rule of law is woefully under-theorised.'<sup>44</sup> They emphasise the rule of law as an equilibrium concept, arising from the interaction of institutions, beliefs and behaviours. Groups can resist and sabotage efforts to establish legal constraints on behaviour. However, the idea that political support for the rule of law will automatically evolve does not necessarily hold.<sup>45</sup>

Taken as a whole, the institutional literatures continue to work with a highly abstract notion of law. At the extreme, they simply assume that a government that establishes a set of institutions characteristic of existing stable legal regimes – legal codes, well-trained judiciaries, enforcement agencies – will thereby institute the rule of law. But these accounts fail to explain why these institutions in many developing countries are hopelessly corrupt and ineffectual.

The authors produce a model for understanding a country's evolution towards the equilibrium rule of law, conceptualising its attainment essentially as a collective action problem.<sup>46</sup> They conclude that attempts to attain the rule of law often fail because they have not sufficiently considered pre-existing normative social and legal orders. Attaining the rule of law is thus less about introducing laws than harnessing and modifying the existing set of norms to ensure that defection is credibly punished, thus attaining a new equilibrium.<sup>47</sup> In the game theoretic model below, political stability is the equilibrium concept. This stability is a prerequisite for establishing the rule of law. The key contribution this paper makes is to identify the fact that governance initiatives should not assume stability, let alone rule of law. They should rather try to attain both and in that order. Prescribing better fiscal management, for instance, is not good policy advice when political stability cannot be assumed.

## GAME THEORETIC MODEL

Robert Bates offers a simple game theoretic model by which to formalise the narrative for each country case.<sup>48</sup> The model is appropriate for understanding the dynamics of an elite bargain and how violence potential among competing groups may be ameliorated for the sake of attaining political stability, a prerequisite for growth. Three questions inform his agenda for the model:<sup>49</sup>

- Under what conditions will citizens choose to disarm, trusting government to protect their life and property?
- Under what conditions will specialists in violence choose to employ force to defend their citizens rather than to exercise predation?
- When will these choices prevail as an equilibrium?

Players: Two citizens (or groups of citizens),  $i$  of  $\{1, 2\}$ , and one specialist in violence ( $G$ ), for example, the ruling coalition.  $G$  does not possess a monopoly over violence in the Weberian sense and the citizens have access to arms.  $G$  can only achieve a monopoly over violence if citizens disarm. The equilibria of the game suggest conditions under which order is likely to prevail or disorder likely to arise. Each citizen possesses a given amount of resources, denoted by  $T_i$  (time) that can be allocated between work ( $w_i$ ), military preparedness ( $m_i$ ) and leisure ( $l_i$ ):

$$\text{Citizen } i \text{ of } \{1, 2\} \text{ chooses } w_i, m_i, l_i \geq 0, \text{ subject to } w_i + l_i + m_i \leq T_i \quad (1)$$

Resources devoted to work are productive, resulting in an output  $F(w_i)$  for player  $i$ . Resources devoted to military activity are unproductive. After allocating their resources, citizens sequentially decide whether or not to raid the other's possessions. Player 1 chooses first. The quantity of Player 2's assets and their relative strength determine the amount that can be gained from raiding. Citizens derive their utility from income and leisure. Income  $Y$  can be increased by working or by raiding other players' possessions.  $G$  also seeks to maximise utility, but does so through the use of force (as a specialist in violence).  $G$  can increase its wealth through predation or fee collection (taxes  $t$ ) for providing security to citizens seeking to produce wealth or enjoy leisure. These dynamics represent a military balance between  $G$  and citizens, and the following assumptions are made explicit:

- 1 When  $G$  engages in predation  $P$  (say, to raid the wealth of Citizen  $i$ ), success ( $S$ ) is characterised by some probability  $p$ , depending on the relative armed capacity of  $i$ .
- 2 Given the above,  $G$  only engages in predation if probability of success ( $p$ ), or expected revenue ( $ER$ ),  $ER \geq m_i$ .
- 3  $G$  can raid only one citizen per time period:

If  $G$  decides to raid either or both citizen groups,  $ER$  is equal to the probability ( $p$ ) of success ( $S$ ) multiplied by the income ( $Y$ ) for citizens combined, less the taxation from citizens that could ordinarily be derived in the absence of raiding:

$$\text{If } G \text{ decides to raid } I, ER = (p S \times i Y) - i t \quad (2)$$

If  $G$  decides not to raid,  $ER$  is equal to ordinary taxation derived from citizens' productive activity:

$$ER = i t \quad (3)$$

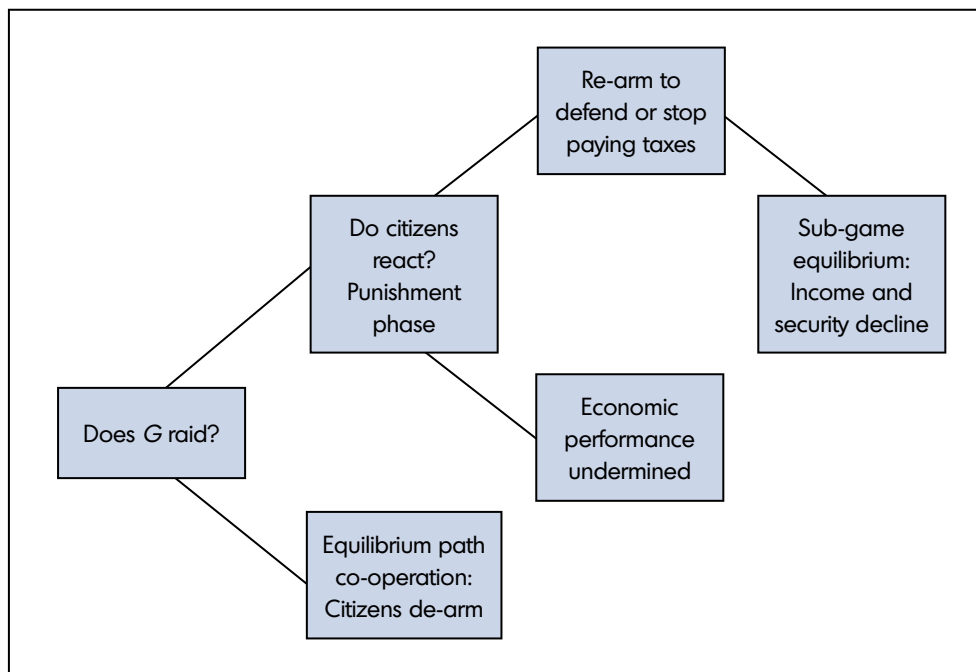
Conditions under which equilibrium is achieved lay the foundation for political stability and the maintenance of the elite bargain holding the dominant coalition together.

$G$  provides security and refrains from predation. Citizens refrain from  $m_i$  and choose some combination of  $w_i$  and  $l_i$  instead.  $G$  has to tax the population at a sufficiently high rate to avoid the incentive to extract rents elsewhere, but also at a sufficiently low rate so as to provide citizens with incentives to work instead of taking up arms.<sup>50</sup>

To locate such an equilibrium, we cast the interaction between  $G$  and the citizens as a repeated game; in such a setting, prospective losses help to define the equilibrium path of play. The principal threats of interest in this game are the losses that arise from state failure. When states fail, specialists in violence turn to predation; they become warlords.

A decision tree may be depicted as follows:

**Figure 3: Decision tree for the sub-game**



Source: Author's compilation, adapted from Bates RH, *When Things Fell Apart*. Cambridge: Cambridge University Press, 2008

If the government decides not to raid, the equilibrium path will likely be followed. If it does choose to raid, however, the question becomes whether citizens choose to react. If they choose not to, economic performance is jeopardised, but the trajectory towards state failure is avoided. If citizens do react, however, either through taking up arms or refusing to pay taxes (or some combination thereof), the sub-game equilibrium of declining national income and security will likely be realised.

The sub-game equilibrium in Bates's model is a reversion to the payoffs under state failure, which is generally the very threat that promotes adherence to the choices that yield

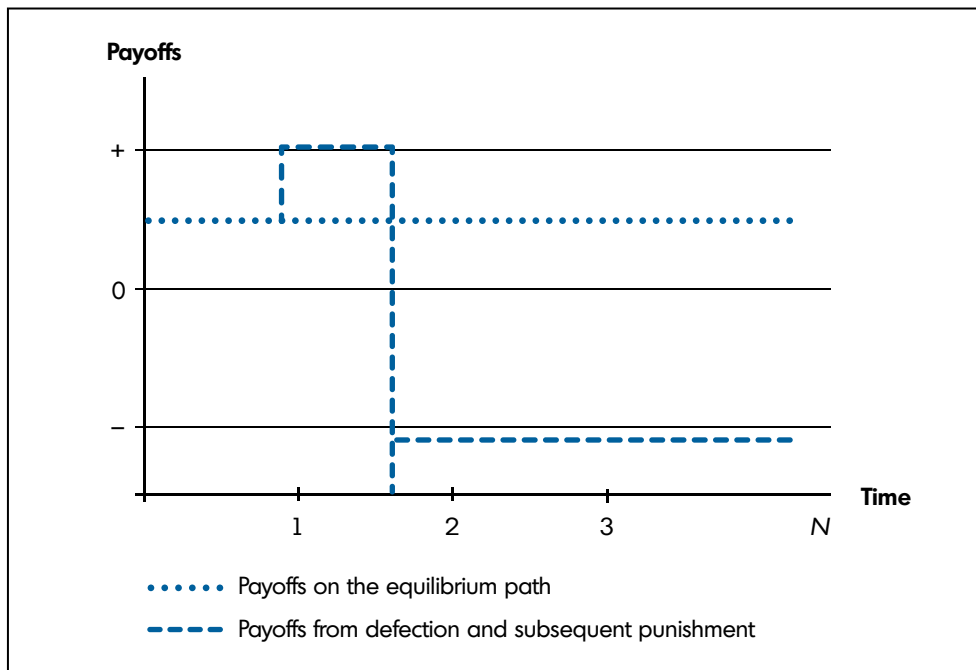


political order. More precisely, the conditions for political order (or the maintenance of an elite bargain that supports improved economic performance) are as follows:

- 1 Each citizen  $i$  chooses some combination of  $w_i$ ,  $m_i$ ,  $l_i$  optimally (given the other players' strategies). They refrain from raiding and pay  $t$  to  $G$ , provided the other citizen group has not raided and  $G$  has refrained from predation. In the absence of these conditions, players revolt by refusing to pay taxes and engaging in self-defence.
- 2  $G$  refrains from looting so long as neither citizen group raids or fails to pay taxes. Failing that,  $G$  becomes predatory and seizes the citizens' wealth.

How the dynamics of the game change when an exogenous windfall such as new oil rents enter  $G$ 's coffers is the question at stake.  $G$  would presumably have a diminished incentive to impose taxes, but Citizen  $i$  may have an increased incentive to take up arms against  $G$ , or to raid the other citizen group if they happened to be favoured by  $G$ , assuming it may be a strategy of  $G$  to extend patronage to one citizen group to serve as a buffer against revolt from the others. Furthermore, if lootable natural resources are cheaply available to Citizen  $i$ , engaging in  $m_i$  becomes less costly. An exogenous injection of wealth to  $G$  may thus cause a deviation from the strategies that had previously ensured that equilibrium conditions were met. Figure 4 depicts the payoff structures both on and off the equilibrium path:

**Figure 4: Payoff structures on and off the equilibrium path**



Source: Bates RH, *When Things Fell Apart*. Cambridge: Cambridge University Press, 2008, p. 265

In order for *G* to forgo the short-run benefits of predation, the threat of state failure must be credible, such that the benefits to *G* of continuing to rely on taxes (generated through productive activity,  $w_i$ , by citizens) sufficiently outweigh the benefits of predation. The low payoff levels off the equilibrium path deter predation. However, should *G* be assured of high levels of income in the form of oil rents even in the context of political disorder, the credibility of the threat of state failure is undermined. As suggested above, exogenous windfalls may also reduce the incentive to tax citizens, thus increasing *G*'s incentive for defection. Such windfall wealth may also cause *G* to discount the future at too high a rate, especially if it perceives that the elite bargain holding the dominant coalition together is insecure. 'The temptation to veer from the equilibrium path would thus strengthen, raising the likelihood of actions that would provoke state failure. [...] And should a major new source of wealth arise – a resource boom, say; or discoveries of oil or mineral deposits',<sup>51</sup> citizens might anticipate that *G* now has a stronger incentive to engage in predation than in protecting them. This creates strong incentives for citizens to revert to private security provision. Less time is consequently available for productive work. Economic performance is therefore undermined and the citizen–state accountability link, ordinarily forged through taxation, is severed. The model generates a proposition that 'governments in economies that contain valuable resources should experience higher levels of disorder than governments in other economies'.<sup>52</sup> The proposition does not necessarily consider that in order for resources to be extracted, foreign investment is required. The constraints under which foreign actors operate therefore become particularly important to consider; for instance, Chinese firms may operate more unscrupulously than listed companies that are subject to stricter home-country regulations such as the Dodd–Frank Act, thus increasing the probability of veering off the equilibrium path.

In the case studies that follow, each country will be assessed in terms of the model outlined above and how future oil revenue dependence is likely to influence the dynamics of the elite bargain or how it has already started to influence those dynamics. Any policy recommendations must properly consider these political dynamics if they are to gain meaningful traction.

## CASE STUDIES

### Tanzania

Between 2005 and 2011 extractive exports grew from 12% to 37% of total exports. Natural resource dependence has increased substantially and will likely be amplified by impending oil rents. In the same period, GDP per capita has grown from \$1,030 per person to \$1,336, though almost every governance indicator has declined. Rule of law, for instance, declined from 45% to 34% (in 2012). Control of corruption improved drastically from 2005 to 2006 (from 30% to 52%), but then declined precipitously to 22% in 2012.<sup>53</sup> Corruption is of particular concern in Tanzania, as the literature records numerous instances of government officials accepting bribes to allocate licences or sitting on the boards of foreign corporations, which end up paying relatively little tax.<sup>54</sup>

This suggests that while individuals within the ruling coalition gain, the state and citizens have become relatively worse off. Criticism has been levelled against the current government over the terms on which mining concessions have been granted to foreign capital. Kelsall notes, for instance, a lead article in Tanzania's *Business Times* in 2003 which stated that, 'while the Tanzanian government stood to earn \$75 million from the investment at Bulyanhulu, the Barrick Gold Corporation would take home \$3 billion. [...] Meanwhile high-ranking individuals within politics are rumoured to sit on the boards of directors of these firms.'<sup>55</sup> Kelsall essentially argues that public institutions and economic reform in the direction of liberalism (to attract foreign direct investment) are not sufficiently legitimate in the public mind to achieve the government's stated aims for capitalist development under democratic rule of law. The argument appears to be sustained by other independent research.

Anthropologist Siri Lange, for instance, recorded citizen attitudes towards the government, particularly pertaining to amendments to the 1998 Mining Act, enacted in 2010, and found that across four of Tanzania's mining areas<sup>56</sup>

[t]here is a strong feeling among people of having been 'betrayed' by their own government (*serekali*). Bitterness is fuelled by the fact that large-scale mining has contributed little to the government coffers. [...] Mining [...] has become [...] a major factor for ordinary people's increasing resentment of the state.

However, Kelsall has suggested that part of the challenge of initiating reform is that citizens remain relatively powerless, fragmented and unlikely to challenge the power of the state, especially insofar as they are dependent on the largesse of state officials for their welfare. Similarly, citizens view new political parties as a potential source of patronage, undermining the credibility of opposition politics. Citizens appear more likely to be consumers than investors in opposition efforts and are unlikely to engage in military revolt. Opposition to the dominant party is therefore unlikely to affect its position in the near future.<sup>57</sup>

Associational life in Tanzania is weak [...] The formation of movements [eg, trade union or human rights] is further impeded in the current conjuncture by the prevalence of multiple occupations in people's subsistence strategies, a plurality that tends to impede the organisation of minimally stable class or occupational blocs.

Co-operation between citizen groups required to effect revolt therefore seems unlikely, as it is relatively costless for ruling elites to play one group off against others through the use of side payments. A 2003 study on Tanzania's Tax Revenue Authority further demonstrated how kin and family networks invariably see a job in the public sector as a rent stream for the network. To refrain from 'corruption' is essentially seen as selfish. Accepting bribes is thus (informally) normalised.<sup>58</sup> Even where citizens are totally excluded from patronage and subject to human rights abuses such as displacement (often as a result of mining activities), the resultant grievance is unlikely to translate into revolt unless other obstacles are overcome (eg, weak civil society movements and collective action problems).

Citizens, while unlikely to resort to military activity, are also unlikely to engage in productive activity if sufficient income can be derived through patronage, especially in a context of relatively limited economic opportunity for an expanding workforce.

Lange offers substantial evidence of a predatory state in action, the opportunities for which are created by the elite bargain between the state and foreign mining corporations. In one example, Rockland Tanzania was granted a prospecting licence for 10 km<sup>2</sup> in an area belonging to Lendanai village. A number of Maasai families depend on a water source within that area, which had been established and protected since the 1940s. The company then forbade 'trespassing' into the area, denying access to the water. Government protected the company:<sup>59</sup>

Neither of the authorities that are supposed to represent local communities [...] appeared to be concerned about the water source. The Maasai strongly suspect the company of having bribed councillors to vote in favour of the mining company, and witnesses had seen representatives of the company offering cattle and beer to other members of the Maasai community to win their consent.

The case fortunately ended in favour of the Maasai, although that was attributable to the rare occurrence of one well-connected individual challenging the company through legal channels. In the other cases, state collaboration with foreign corporations successfully employed side payments to play one citizen group off against another or simply excluded citizens altogether.<sup>60</sup>

The population in general [...] is extremely resentful of large-scale mining. [...] The central government has kept mining contracts confidential, [...] and many Tanzanians also believe [...] that high-ranking political officials [sic] own shares in some of the mining companies.

Some lessons appear to have been learnt from the experience with mining corporations. The country has, since the Maasai case, changed the terms for companies signing agreements for exploration and production contracts for crude oil and natural gas. In an attempt to maximise its rent stream in the short run, given the long lead time of most extractive industry projects, the model unveiled by the Tanzania Petroleum Development Corporation requires firms to pay a signature bonus of \$2.5 million on signing of production sharing agreements (PSAs), and a further payment of at least \$5 million when production begins. Companies will additionally pay a royalty rate of 12.5% of total oil and gas production for onshore operations and 7.5% for offshore operations.<sup>61</sup>

It remains to be seen whether this will be sufficient to overcome the potential path dependence dynamics set in motion by the elite bargain that characterises mining. Oil rents tend to prise open existing fissures, and mining alone bears evidence of both dimensions of the rentier effect. Political dynamics suggest it is unlikely that citizens will take up arms against the government. However, the game decision tree suggests that predation will result in sub-optimal economic performance if not the sub-game equilibrium of instability per se. This is further verified by Polity IV's fragility index that scores Tanzania a relatively stable 10 (with the most unstable being the Democratic Republic of the Congo at 23).

## Uganda

Unlike Tanzania, Uganda's extractive industry exports are relatively low as a proportion of total merchandise exports. Agriculture and manufacturing exports account for the majority of foreign revenue. Tax revenue as a proportion of GDP rose from 12.9% to 16.1% between 2008 and 2011. Despite performing relatively well on the World Bank's rule of law score – 44.49% in 2012, which was its highest ever – Polity IV's fragility matrix ranks it a highly unstable 17 for the same year. Combating corruption has declined from 28.7% in 1996 to 17.7% in 2012. These indicators carry a sense of foreboding regarding oil rents.

Critical junctures from Uganda's early post-independence history suggest path dependence towards a repression effect. Milton Obote abrogated the constitution in 1962 and stripped the former Buganda king, Kabaka Mutesa I, of his authority, making himself the *de facto* president. Their dispute culminated in Obote's dispatch of the army to suppress the political and security threat posed by the Buganda. The elite bargain subsequently struck by Obote consolidated the control of the military, but with adverse future consequences. Comparing the effects of indirect rule in Uganda and Ghana with Sierra Leone, Acemoglu *et al.* note that chieftaincy systems only persisted as a central feature of post-colonial governance when they were relatively weak and easily co-opted by new elites.<sup>62</sup> In Uganda it is a mixed blessing that, in fact, the chiefs' power was diminished; for instance, it avoided the state weakness that ensued in places such as Sierra Leone as a result of chiefs holding *de jure* political power. Others contend, however, that quashing chiefs' power may have led to communities affected by oil extraction being under-represented, thus leading to citizen grievance – a potential source of instability.<sup>63</sup>

Despite developing a monopoly over the control of violence, the current president, Yoweri Museveni, and his National Resistance Movement's (NRM) history of using the military as a means of gaining and sustaining political control, means that 'its armed forces will be both emboldened by the prospects of oil revenues [...] and bolstered to protect oil installations.'<sup>64</sup> Though increasing grievance seems unlikely at this stage to spur citizens to replace productive activity with military revolt, the history of civil war and military repression, combined with a much higher future oil dependency ratio than Tanzania, suggests a higher likelihood for both a repression effect and a higher propensity towards instability.

A 2012 research report by SAIIA records one community member from Kabaale Parish, a Lake Albert village, warning that '[i]f government continues with its top-down approach, there will be misunderstandings and conflict in this area'.<sup>65</sup> The comment was made in the context of potential community displacement to make way for an oil refinery. It is difficult to see how good communication could be costly to the dominant coalition, especially if the lack thereof is likely to contribute to avoidable citizen revolt. The elite bargain in Uganda excludes non-elites by design, but it seems unnecessarily risky to perpetuate fear in a manner that could cause political instability, a threat to the dominant coalition's own security.

Land tenure insecurity further contributes to a high-risk scenario for Uganda. Residents do not possess title deeds as customary practices preclude this right, thus creating an inherent disincentive to invest in the land. This is compounded by uncertainty over displacement, which<sup>66</sup>

has led to some families halting their agricultural activities because of the fear of removal from communal lands. This has caused food shortages and psychological stress [...]. Such social tensions hold severe political and localised conflict implications. Tensions between Ugandans and Congolese for access to land, combined with exploration and oil-production activities, are creating conditions conducive to violent confrontations between residents.

Uncertainty and secrecy dominate plans for oil exploitation in Uganda. The potential for violent confrontation between citizens and the state is driven by a lack of economic opportunity, resulting in reduced tax revenue, potentially increasing the incentive for the state to 'raid', to use Bates's game theoretic language. In this context, incentives for citizens to spend more time investing in military preparedness become more powerful than investing in productive activities, especially if access to oil wealth can be attained through military activity. The decline in taxable economic activity is not an immediate concern for the government, though, as the loss in taxable revenue seems more than compensated by the planned PSAs with the foreign oil companies involved.

Despite relatively uneventful elections in February 2011, with Museveni winning a 68% majority, signs of instability and frustrations with predation occurred just two months thereafter in the form of civil riots. The state did not hesitate to employ military force to suppress the riots. Sturman also finds further evidence for the repression effect, most importantly in an alleged Russian 'oil-for-arms' deal and increased military expenditure beyond donor stipulations.<sup>67</sup>

Predatory behaviour by government officials is strongly perceived, even within the ruling coalition. 'Allegations of bribes paid by oil companies to three cabinet ministers ignited a series of oil debates in the Ugandan Parliament',<sup>68</sup> which led to parliamentarians attempting to stop the transfer of production and downstream rights from Tullow Oil to Total and the Chinese National Offshore Oil Company. However, Ugandan MPs are hardly immune to co-optation themselves. Sturman records, for instance, that parliament approved a \$260 million supplementary budget to fund Museveni's re-election campaign.<sup>69</sup> Nevertheless, the 'oil debates' in parliament have given the appearance of hitherto unseen oversight of the executive.

Most importantly, however, these oil debates were not divided along party lines. That members of the NRM have spoken out against bribery has led Mahmood Mamdani to interpret these occurrences as reflective of internal fractions in the NRM.<sup>70</sup> Sturman writes:<sup>71</sup>

If Mamdani is correct in his analysis that some NRM members are using oil governance as a point around which to plan the internal ousting of their long-standing president, then the trend for oil to entrench the powers of an incumbent leader may be broken in Uganda.

This is, of course, conditional on the emergence of a strong civil society and the existence of credible opposition parties to step into the potential vacuum that will be created by a disintegrating NRM. Whichever faction of the NRM controls the military will be another key determinant of political outcomes, a question that remains unanswered.

In March 2013 Museveni, still firmly at the head of Uganda's government, signed the 2012 Petroleum Bill into law. It was gazetted the following month as the Petroleum Exploration, Development and Production Act of 2013. This Act was designed to guide the establishment of the Petroleum Authority of Uganda and the National Oil

Company,<sup>72</sup> in addition to regulating the licensing of commercial entities in the oil sector. Two accompanying pieces of legislation remain unsigned, however, contributing to the persistent sense of regulatory uncertainty.

Overall, a fragile elite bargain is likely to be a curse for Uganda. Oil rents will in all likelihood widen existing fissures. The government appears to be operating under increasing insecurity, though the threats to its dominance remain predominantly internal. This shortens the time horizons and increases the discount rates for currently ascendant members of the ruling coalition, which generates incentives for increased predation for as long as they enjoy a dominant political position. Bates's model thus predicts a sub-game equilibrium outcome even though the probability of citizen revolt is not the preeminent threat.

### **Liberia**

From the end of the civil war (in 2003) to 2011, Liberia's GDP per capita grew from \$346 to \$517,<sup>73</sup> the latter still nearly three times lower than Tanzania's. Oil was discovered in 2012 but production had not yet commenced at the time of writing. By 2010 the extractive industries contributed only 2% of GDP (a mere \$1.5 billion in 2011), even though Liberia is endowed with extensive iron ore, gold and diamonds.

When President Ellen Johnson Sirleaf assumed power in 2005, Liberia's control of corruption score was 14.1%. By 2007 it had soared to 47.1%, only to recede to 34% by 2012; a mild improvement on the 2011 score. Liberia scores similarly to Uganda on Polity IV's fragility index at 16 (for 2012). However, the World Bank ranks it at 31.8 (out of 100) of all countries surveyed for political stability (0 is highly unstable and 100 is most stable), whereas that figure was only 11.1 in 2005, suggesting a marked improvement but remaining risk.<sup>74</sup>

Liberia endured one of the most prolonged civil wars in Africa's history. It claimed over 250 000 lives and maimed countless others. A complex web of patronage networks has evolved in its wake. Economic opportunities in the new order are integrally linked to military command structures from the war.<sup>75</sup> Former warlords presumably have a strong interest in maintaining stability for as long as the rents received from current economic opportunities outweigh the cost of returning to violence. However, the state does not have consolidated control over the military and the reality for citizens during the two phases of the war was intermittent switching between productive and military activities. In question is how future oil rents are likely to influence the current equilibrium.

William Reno's analysis of the Governance and Economic Management Assistance Programme's (GEMAP) anti-corruption efforts since 2005 is instructive, as Liberia provides a prime example of how external policy prescriptions are unlikely to gain traction in the absence of understanding the complexity of the domestic political economy.<sup>76</sup>

Contemporary relationships of corruption and authority, both inside and outside the state administration, have become much more intertwined, resembling a network much more than a hierarchy as compared with the pre-1980 period. This evolution of corruption has changed the way that local elites struggle for supremacy through markets, often in ways that sudden political and economic reforms fail to anticipate.

Too often corruption is conceptualised as an obstacle to stability, mutually exclusive to it. Reno demonstrates that, in fact, external efforts to minimise corruption can inadvertently create instability. In contrast, some types of corruption may entice members of the elite, within both the state and civil society, to tolerate a more inclusive political settlement. 'Ruling the networks of strongmen often precedes the rule of law.'<sup>77</sup> Arguably, the toleration of some corruption before the 2005 elections enabled new entrants to the political game, avoiding the consolidation of wartime incumbents to the exclusion of non-elites. Given the importance of inclusivity for stability, this argument cannot easily be overlooked. While corruption is a serious concern in considering the likely effects of oil revenues, it may be less important than the potential exclusion of non-elites that oil rents tends to produce.

Reno records that pre-existing military structures, ingratiated with local strongmen elected to the new democratic legislature, facilitated the entry of former fighters into commercial activities that diversified the economy.<sup>78</sup>

Although it is hardly fair to reward what many people consider to be corrupt and violent figures from wartime, this compromise maintains important commercial activity and diverts the energies of those who could disrupt post-war agreements to private pursuits.

Future oil rents accruing to the state may reduce the incentive for the ruling party to maintain an awkward but inclusive elite bargain. However, it is also possible that the new ex-militia networks would seek business opportunities along the oil value chain. Either way, even the most powerful individuals probably have insufficient leverage within the dominant coalition to use oil rents to gain monopoly control over the use of violence, thus minimising the threat of a repression effect. However, that the finance ministry will be the primary recipient of oil rents means that researchers should keep a careful eye on the most powerful individuals within that ministry.

From 1847 to 1980 the Americo-Liberian elite maintained a remarkably stable elite bargain.<sup>79</sup> In 1926 it colluded with the Firestone Tire and Rubber Corporation to operate the rubber plantations with coerced labour. Between 1950 and 1970 Firestone provided over 60% of the state's revenues, reducing the need to tax wealthy citizens. 'This reinforced the hierarchical organisation of patronage-based corruption centred on the person of the president.'<sup>80</sup>

When Samuel Doe came to power in 1980 through a military coup, he was 'politically vulnerable and had to rely upon people with whom he did not share the kinds of personal ties and insider knowledge that had benefited previous presidents',<sup>81</sup> indicating a profound shift in the dynamics of the elite bargain. Fragmentation under Doe led to increased state predation as his time horizons narrowed and the discount rate soared. However, instead of trying to attain control over the military, Doe resorted to co-optation, inadvertently creating a broader coalition. One of his strategies to assuage internal threats was to strike a bargain with the vulnerable Mandingo ethnic group, previously excluded from patronage largesse. He also developed illicit partnerships with foreign firms, which undermined the institutional capacity of the state and encouraged repatriation of profits abroad. However, as Reno remarks, Doe's corrupt gains of \$300 million were less important than the organisation of his patronage network: 'People who became businessmen, protectors of minority rights and local patrons also were corrupt insiders and prolific abusers of human



rights.<sup>82</sup> As Bates's model predicts, Doe was unable to maintain a stable equilibrium as his discount rate simply became too high. That he was ousted from power does not, however, diminish the role of elites in institutional persistence, illustrated by the appearance in the 2005 legislature of former warlords:<sup>83</sup>

Winners included Senator Jewel Howard-Taylor, Charles Taylor's former 'First Lady', and Senator Prince Johnson, Taylor's former associate and the man who many consider responsible for Doe's murder. Representative Edwin Snowe, Speaker of the House of Representatives until he resigned in 2007, was listed in the UN travel ban report as an 'Associate of former president Charles Taylor with ongoing ties to him'. Snowe also allegedly diverted revenues from the state-owned Liberia Petroleum Refining Company for his and his followers' personal use.

Decentralised patronage networks appear prolifically in state institutions. No amount of new rules pertaining to oil revenue management is likely to ameliorate the associated inefficiencies. Reno correctly warns against external attempts to limit corruption (eg, GEMAP), as they often fail to consider that decentralised patronage networks may sustain stability. External intervention also gives the appearance of favouring some groups over others, which raises the risk of grievance on the part of those who feel excluded.

Oil rents are likely to amplify the rentier effect in Liberia. Government predation is unlikely to fuel further instability, given the broad elite bargain and balance of de facto power (ironically forged under Doe's leadership). Optimal economic performance will be undermined in the short run, though this is preferable to a collapse into anarchy. The current equilibrium is likely to be robust to the impact of oil rents, as citizens are unlikely to revolt against the ruling coalition, given their complex dependence on patronage networks operated by members of that very coalition. Although the incentive to reduce citizen taxation will be strong, taxation is not the glue that holds the dominant coalition together. Foreign oil companies will provide the majority of state revenue, reducing the immediate need to tax economically productive citizens: 'The Finance Ministry receives all payments from mining companies. Under new laws that have not yet been fully implemented, most mineral revenues will be transferred to the treasury'.<sup>84</sup> Citizen members of decentralised patronage networks will likely try to find work instead of resorting to military revolt, which further strengthens the argument that equilibrium will be retained, though it may be somewhat fragile.

## Ghana

As a proportion of total export revenues, the contribution of the extractive industries grew from 8% in 2005 to 56% in 2011.<sup>85</sup> Although gold still contributes the majority of revenue for the sector, recent growth in oil production has elevated its importance. Oil revenues were 6% of total government revenue in 2011, and the projections are that this figure will only rise as high as 30%, a significantly lower figure than in the other cases explored thus far. How Ghana responds to its oil windfall has been a pressing question at least since 2010.<sup>86</sup> As Gyimah-Boadi and Prempeh put it: 'Is Ghana's democracy resilient enough to withstand the perils of the resource curse?'<sup>87</sup> The African continent as a whole is anxious that if oil rents reverse Ghana's profound political progress, little hope remains

for other countries. Ghana has the advantage of a democracy that has been robust enough to accommodate changes in political power. The political opposition has a meaningful chance of winning an election without resorting to violence. This is not commonplace across the African continent. GDP per capita growth is remarkable too in purchasing power parity terms. This rose from 5.5% in 2009/2010 to 11.8% in 2010/2011. Its 2011 value stood at \$1,652.

Ghana scores a high 8 on Polity IV's rankings for quality of democracy and a low 11 for fragility. Control of corruption declined from 60.5% in 2010 to 55.5% in 2012, for reasons that the following analysis reveals. Ghana falls on the global median line for the World Bank's political stability rankings (49.7 in 2012, down from 52 in 2011). The high degree of contestation around the December 2012 elections was a source of concern. The opposition New Patriotic Party (NPP) contested the results in court with judicial proceedings streamed live on television. The Supreme Court ruled in favour of the incumbent National Democratic Congress (NDC) on 29 August 2013, pronouncing that the party had, in fact, won the elections by 50.7% to 47.7% in 2012. The NPP accepted the result and its leader, Nana Akufo-Addo, urged his supporters to do the same peacefully. President John Mahama (vice president under John Atta Mills, who died in office in 2012) was inaugurated in January 2013 despite the judicial appeal from the NPP. While some analysts remain sceptical, the overall indication is that Ghana's democracy is sufficiently robust to withstand the challenges posed by oil rents; careful analysis may indeed be needed to ascertain the specific points of vulnerability:<sup>88</sup>

Ghana's development record generally has not matched the promise of its resource wealth and cocoa earnings. Poor political and economic management of the country's resources are [sic] among the reasons for this disappointing record. Given their more immediate and substantial revenue impact, Ghana's oil rents may present even greater challenges for the country's leaders than rents from gold or cocoa.

At a general level, Ghana has an independent media, an active civil society and a strong opposition in the legislature. In particular, impending oil rents – at least in the short run – have created a focal point around which civil society has united. For instance, the Civil Society Platform on Oil and Gas includes more than 110 think tanks, community-based organisations, environmental groups, activists and local oil policy experts. The platform has 'played a crucial role in developing Ghana's oil-management framework and ensuring transparency in the process of establishing it'.<sup>89</sup> Before 2010, when oil production began, neither a revenue management law nor an independent regulator existed for the oil and gas sector. Although the platform failed to have a moratorium passed on the issuing of new exploration licences until such institutions had been established, its attempt put civil society on the radar and it has been a formidable instrument of vertical accountability over the past three years.

It is unusual for the prospect of oil rents to unite civil society. In weaker institutional contexts, it would have been easy for ruling elites to play citizen groups off against one another. In Ghana, however, civil society has united in a manner that has discouraged predation by the state. This analysis strongly contrasts with Okpanachi and Andrews' argument that civil society in Ghana is inherently splintered and such a coalition is unsustainable.<sup>90</sup> Gyimah-Boadi and Prempeh do, however, warn that the focal point

achieved thus far is in danger of being undermined through divergent donor interests and civil society's resultant lack of capacity to monitor single issues over a prolonged period.<sup>91</sup> Moreover, the platform was unable to defeat amendments to the Petroleum Revenue Management Act that now allows the state to engage in oil-backed borrowing. The latter practice tends to be problematic as such loans can result in high external indebtedness, with attendant difficulties in repayment if the oil price plummets.

The Public Interest and Accountability Committee (established by the Civil Society Platform) revealed further danger of predation in a report that examined the state's initial management of oil rents.<sup>92</sup> For instance, the government transferred roughly 50% of the oil rents received in 2011 to the Ghana National Petroleum Company (GNPC):<sup>93</sup>

GNPC's financial investment activities have historically been opaque and subject to little public or even parliamentary scrutiny. Given that GNPC is run by influential insiders from the NDC and their allies, the lack of transparency and oversight in its financial affairs is worrisome.

Growth in patronage politics due to oil windfalls may fuel more extensive predation. Gyimah-Boadi and Prempeh argue that the winner-takes-all political system produces a high-powered incentive for the incumbent party at any given time to employ the apparatus of the state to improve its re-election probability through expanding public sector job opportunities and related activities such as construction contracts.<sup>94</sup>

While in office both parties have sought to gain access to as much oil money as possible as quickly as possible. [...] Partisans on both sides fear the opportunity to distribute patronage on a greater level than ever before could entrench the winning party in office over several more election cycles.

This may also explain why the NPP challenged the NDC's electoral victory so vehemently.

As a result of these dynamics, a change in government tends to result in extensive reallocation of civil service positions, resulting in discontinuity in the provision of public services and policy direction. The authors argue that the high degree of electoral competition skews political incentives and government spending in favour of influential interest groups for the sake of attaining short-term electoral payoffs for the incumbent. This comes at the opportunity cost of investment in strengthening institutional quality, which would benefit the nation over the longer term. Youth unemployment also makes young citizens particularly susceptible to being conscripted as 'foot soldiers' for respective parties. Oil rents are likely to create a large funding pool for the NDC to drive these activities. The upshot is a rentier effect that is likely to undermine future economic performance but unlikely to produce political instability.

The incentive to use oil rents to maintain power appears stronger than the incentive to continue diversifying the economy. In the absence of employment opportunities elsewhere, incumbent elites are likely to increase the size of the public sector (incurring efficiency losses for society) and narrow the tax base (which would otherwise have been broadened through diversification). Combined with the already pernicious effects of oil crowding out the competitiveness of other sectors (as per the Dutch disease hypothesis), this does not bode well for sustaining a balance of power between citizens and the state, as

the latter can easily rely on tax revenue from foreign companies invested in the country's oil sector.

Overall, however, the probability of decline into the sub-game equilibrium (as per Figure 3) in Ghana is far lower than in the other countries examined, both because the ratio of future oil rent to tax revenue is lower and because existing institutional quality improves. Economic performance may be weakened, but underlying political resilience suggests that Ghana is likely to overcome the potentially destructive effects of an oil revenue windfall.

### CASH-TO-CITIZEN TRANSFERS

Diamond and Mosbacher argue, along with oil scholar Todd Moss, that merely attaining improved transparency of revenue rent flows is inadequate to the task of establishing the necessary incentives to spur inclusive development. Because the accrual and distribution of rents is only one dimension of the process from extraction to developmental outcomes<sup>95</sup>

[i]t is time to try a new policy approach [...]: the direct distribution of a proportion of oil revenues to citizens as taxable income. [...] When a government received revenue from oil and gas exports, a certain predetermined proportion of it (ideally, at least 50 percent) would immediately be distributed directly to the bank accounts of the country's citizens. Then, the government would treat those distributed revenues as income and tax some of it back. [...] Directly distributing oil revenues as taxable income would create a broad and active constituency of citizens who were directly affected by the government's management of their resources, in place of the often passive populations of corrupt, resource-cursed states. In a single step, it would build a broad domestic tax base – a fundamental piece of any modern, well-governed state.

The authors respond to the immediate critique of infeasibility by pointing to examples of cases in which such direct taxable transfers have already occurred. They rely on the ability of technology (eg, biometric identification and mobile banking) to overcome practical barriers. Politically, they suggest that the fact that 9 of the 12 countries initially mentioned are democracies is sufficient to overcome the incentives that politicians would otherwise have to block such revenue-distribution systems. 'A broad coalition of forces in civil society and politics could compel rulers to implement some kind of oil-to-cash model, or else vote into office an opposition party that has pledged to do so.'<sup>96</sup>

Of the cases examined above, Ghana is the only one in which such a system would be theoretically plausible. However, the game theoretic dynamics – strong patronage incentives for the party in power and its efficacy in improving re-election probability – suggest that even if the NDC or the NPP were to campaign on such a ticket, their incentive to renege would likely be stronger than their incentive to credibly commit to transfers. Citizens within those patronage networks too are less likely to lobby for cash transfers if it means losing access to current patronage. Civil society groups are more likely to make incremental progress in reforming legislation and building a consensus on the importance of the rule of law than in persuading any given government to reduce citizens' dependence on patronage in the immediate term. Finally, questions over the integrity of biometric

identification for voter registration have already created significant ethnic tensions in Ghana, an issue that remains unresolved. Thus, while the desire for a radical policy move is understandable, it is frankly implausible in even the case that appears most amenable, both politically and practically.

In terms of the NWW classification, Liberia's incipient democracy is progressing from a fragile to a basic LAO, as evidenced by its position in Figure 3. Politics are competitive to a point, but stability is a function of broad coalitions dependent on old war networks. Regime insiders crowd out competitors through the allocation of patronage within these networks. This renders the possibility of functional cash to citizen transfers unlikely. In Tanzania and Uganda, relatively ineffective civil societies and authoritarian politics render a cash-to-citizen policy consideration unfeasible.

The final problem with the cash-to-citizen model as proposed by Diamond and Mosbacher is that paying tax on money freely received is unlikely to forge a citizen–state accountability link that is so necessary for attaining inclusive development. Taxation is only likely to play that role if citizens have engaged in productive work – opportunities for which will only exist through diversified economies. Theoretically, citizens are unlikely to fight for transparency from the ruling coalition because those citizens would be paying tax on that which they did not truly earn through work. The perils of unearned income apply equally to citizens as to the state.

Radical proposals such as cash-to-citizen transfers 'risk a political backlash by violating "political incentive compatibility constraints" [... They also risk] leaving the fundamental political and institutional sources of inefficiencies unchanged and instead deal with some of their symptoms in a superficial way.'<sup>97</sup> As the case studies have aptly demonstrated:<sup>98</sup>

A set of policies which may seem deeply misguided by the standards of basic textbook economics may nonetheless be serving the political economy purpose of holding together a governing coalition. The result may be the rise of new coalitions or new types of equilibria, which might reinstate the market failures or create new ones, because they are useful in binding together the governing coalition or creating rents for the rulers. [...] But more ominously, the results of violating political incentive compatibility constraints might also be a period of civil unrest, with high costs of its own, or even civil war.

One reason prescribed policy reforms are so seldom implemented in Africa is that politicians are aware of the probability that it will lead to disorder, which may threaten their rule. Incremental policy reforms therefore remain most appropriate for trying to prevent the oil curse. Donors would do well to co-ordinate civil society efforts to hold the state accountable for how oil rents are distributed in the long run, given the current dangers of insufficient capacity to stay focused on a single issue for a long time, and the propensity to fragmentation to meet donor expectations. Efforts orientated towards establishing a societal consensus on the importance of the rule of law are also likely to be more fruitful than merely changing laws at a micro-institutional level or introducing radical policy shifts.

## CONCLUSION

Future oil rents hold potential development promise for African countries. However, the extensive literature and experience of oil-rich countries (especially in Africa) offer stern caution.

In the cases examined, it has been shown that the nominal existence of democracy is by itself insufficient to propel countries towards economic dynamism and meaningful political inclusion. Only in instances where the ratios of future oil rents to government revenue are low, and existing institutions relatively strong, is equilibrium stability likely to be maintained. In almost all instances, oil rents disrupt political incentives in a way that is likely to undermine economic performance. Ghana is a potential exception but the bulge of youth unemployment and relatively limited access to economic opportunities outside the extractive industries remain cause for concern.

Cash-to-citizen transfers and variants thereof are not credible policy options in the light of the underlying political dynamics that this paper has sought to highlight. Economic policy prescriptions that ignore these dynamics are sub-optimal. Policy practitioners should, instead, aim to design policies for oil rent management that understand political equilibria and – insofar as is reasonably foreseeable – neither disrupt these equilibria towards instability in the short run nor entrench a predatory elite over the long run.

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