Nigeria and the Petroleum Resource Curse: What Ghana Can Learn For Improved Management of Oil and Gas Revenues

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Abstract - Nigeria discovered oil and gas resources in 1956, and has had poor economic performance and even civil war between 1967 and 1970. The recent discovery of petroleum resources in Ghana is one of the positive shocks that country has experienced in the recent past. How this initial positive shock is converted into durable all round development benefits is argued in this paper to be a matter of policy. Unlike Nigeria, Ghana has an added advantage. It can learn from other countries’ experiences, notably Nigeria and Angola and make better policies to ensure economic growth and sustainability. Casual observation tends to assume that the exploitation of natural resources such as Oil lead to an increase in income with positive knock on effects to poverty reduction. However, research shows that developing African countries that have at least 25 percent of their exports from natural resources are more likely to have conflicts. Resource conflicts seem to be driven by poor governance, greed and corruption. Improved governance of income from petroleum resources in Ghana could reduce the risk of conflict in Ghana provided Ghanian government is ready to learn from Nigerian’s bitter experiences. Collier (2005) argues that conflicts prone countries are more likely to poorly convert their income from natural resources into growth and revenue. He opines that revenue from primary commodities is a risk factor in civil war. This paper argues that Ghana should subscribe to the principles of good governance. Improved governance will help to reduce both domestic as well as regional conflict risks.

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I. INTRODUCTION

The recent oil discovery in Ghana may possibly result into a blessing rather than a curse. Ghana has an added advantage to learn from her closest neighbour, Nigeria in this field and make better policies to ensure economic growth and sustainability. Nigeria however is now having conflict and citizenry become who was in the middle of an oil boom in the 70s and 80s poorer. “Africa has become one of the most promising oil exploration areas in the world over the last decade” (Menachem et al 2004). Ghana is no exception since it’s on the verge of becoming an oil producing and exporting country. Her oil revenues may possibly result into a blessing rather than a curse because it has an added advantage to learn from Nigeria and other countries in Africa and make better polices to ensure economic growth and sustainability.

Bannon and Collier (2003) agree with this notion, they claim that the discovery of new natural resources greatly increases the risk of conflict in low income countries especially if the resource is oil. They also argue that a country that has 25 percent of its GDP dependant on primary commodity exports, has 33 percent risk of conflict while one with 10 percent dependency on primary commodity exports, only has 11 percent risk of conflict. Several African countries have had civil wars linked to resource wealth, for example, Nigeria, Angola, Liberia, Sudan and Congo to mention but a few.

Nigeria discovered petroleum in 1956 and also had civil war and poor economic performance in the last three to four decades. However, country like Botswana, one of the world’s largest exporter of diamond, has sustained rapid economic growth arising from mineral wealth. Ghana could learn from Nigeria’s experiences in order to promote sustainable economic growth through petroleum revenues.

II. ISSUES IN OIL AND GAS FOR DEVELOPMENT

Environmental Concerns and Ghana new oil find

There is no such thing as an environmentally friendly, hydrocarbon industry. Production is messy and use of the end product pollutes and causes climate change. There is no point in pretending otherwise. But Exxon Mobil’s record on controlling local pollution effects at the point of production is abysmal. Their record in Nigeria (and Alaska) is appalling from the point of view of environmental degradation, community relations, repression and major corruption. They have a
reputation as the most irresponsible polluting oil corporation in the World-with the exception of the Chinese National Petroleum Corporation, who are even worse (Murray, 2010).

It is worth a note in praise of Tullow Oil, partners and operators in the Jubilee field an Irish company, their commitment to Ghana and to local employment and procurement has been exemplary. It is vital for the future trial a large part of the energy generated by hydrocarbons, and the resulting revenue, is devoted to funding the industrial development of renewable energy technologies. Ghana has great potential for wind energy, solar energy and above all wave and ocean current energy. Major projects in these areas should be developed with oil revenue.

Corruption

The Ghanaians who have been fortunate enough to acquire stakes in Ghana’s oilfields, are set to become the richest people in the land. Their families may be in a dominant position in Ghanaian society for generations. There is an understandable concern for those Ghanaians and how they acquired their stakes. That seems to be a perfectly legitimate area for investigation, perhaps initially by the parliamentary energy committee.

Many government ministers are at least partly motivated by their opposition to the proposed Kosmos/Exxon Mobil deal by a belief that those close to ex-President Kufuor own a share in Kosmos, with the inference that the share was corruptly obtained. We do not know if that is true. If there is evidence, let it be properly investigated and acted on. If there is no evidence, forget it. But do not let us have policy in the most vital area dictated by partisan rumour.

Strangely, it is bipartisanship which is most worrying, we pray that Ghana will never become corrupt at all levels like Nigeria, even though we know that oil brings that tendency. Yet there appears to be very little vigour in investigating and prosecuting corruption.

Both President John Kufuor and President John Atta Mills, on coming to power after defeating the previous government in election, appear to have taken the same view. As we see it, they judged that in Ghana’s new democracy it is essential that when the government changes, it should be seen by all that vindictive action is not pursued against members of the other party. Only a very small number of middle ranking figures have suffered from anti-corruption action.

These were the actions of wise and generous hearted men. But the danger is that this forbearance can result in a toleration of corruption. A situation can even arise where the political class as a whole see the public purse as something they can loot, with the parties taking turns as they go in and out of power and all the politicians agreeing not to pursue each other for corruption.

We are not saying that Ghana has reached that stage so far, we are saying that it is a danger and that we can be too tolerant as fist become known in Ghana when we warned of increasing corruption in the last years of the Rawlings administration. The same thing happened, only on an even bigger scale, in the last two years of the NPP government.

III. COUNTRY EXPERIENCES

Although Sub-Saharan Africa is blessed with natural resource endowments, there is still a significant amount of people living on less man $1 a day with endless civil wars. Indeed, countries that are greatly dependent on natural resources are more prone to civil wars, which could lead to a reduction in growth and an increase in poverty (Ross, 2003). Furthermore, “violent secessionist movements are statistically much more likely if the country has valuable natural resources with oil being specifically dangerous” (Collier et al, 2003). According to Otters (2007), the resources from the recent oil boom enabled the sub-Saharan countries to address social needs and accelerate socio-economic development. However, African governments face a risk of excess government expansion that could lead to boom-bust cycles that inhibit poverty reduction.

Although, there are some improvements in oil revenue management in Sub-Saharan Africa, more needs to be done to ensure an adequate accounting for revenue and adoption of a rational fiscal policy stance. In addition, because the fiscal stance in most countries has not fully reflected the IMF advice, there has been high volatility of fiscal spending, lack of diversification of government revenue sources and failure to accumulate foreign assets (Menachem et at 2004).

It is often assumed that countries that greatly depend on natural resources are more likely to have economic growth and sustainability however the converse is true for most Sub-Saharan countries. Ross (2003) argues that a country’s reliance on non fuel mineral export or fuel exports tends to create high poverty rates and research also shows that resource-dependent economies grow more slowly than resource-poor economies. Furthermore, the poorer a country is, the more likely it is to face a civil war (Collier and Hoeffler, 2001).
Table 1 below gives an insight on two major puzzles in resource dependent African countries i.e. conflict and poverty. Figure 1 also shows the dependency ratios for both the oil and mineral producing countries. Among the oil dependent African countries, Angola has the highest dependency ratio of 68.5 percent but it is both a highly indebted poor country and has had a civil war. On the other hand, a country like Libya that has the smallest dependency ratio in this example has managed to maintain growth and economic stability.

Among the non-oil dependent countries, Botswana that has the highest dependence ratio of 35.1 percent is neither a highly indebted poor country nor had civil war in the recent years. It is of special interest as to how Botswana has managed to use its revenues wisely although it is highly dependent on diamonds. Perhaps Ghana can learn from Botswana and manage its up coming oil revenues wisely to reduce poverty and ensure economic stability.

Table 1: Resource dependent African countries

<table>
<thead>
<tr>
<th>Minerals</th>
<th>Dependence</th>
<th>Oil</th>
<th>Dependence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Botswana</td>
<td>35.1</td>
<td>Angola^{p}^{*}</td>
<td>68.5</td>
</tr>
<tr>
<td>Sierra Leone^{p}^{*}</td>
<td>8.9</td>
<td>Congo Brazzaville^{p}^{*}</td>
<td>40.9</td>
</tr>
<tr>
<td>Zambia^{p}</td>
<td>26.1</td>
<td>Nigeria</td>
<td>39.9</td>
</tr>
<tr>
<td>Liberia^{p}^{*}</td>
<td>12.5</td>
<td>Gabon</td>
<td>36.1</td>
</tr>
<tr>
<td>Niger^{p}</td>
<td>12.2</td>
<td>Algeria</td>
<td>23.5</td>
</tr>
<tr>
<td>Guinea^{p}</td>
<td>11.8</td>
<td>Libya</td>
<td>19.8</td>
</tr>
<tr>
<td>Dem. Rep. Congo^{p}^{*}</td>
<td>7.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Togo^{p}</td>
<td>5.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cent.I Afri. Rep.*</td>
<td>4.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ghana^{p}</td>
<td>4.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Angola^{p}^{*}</td>
<td>3.6</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

^{p} Represents highly indebted poor countries
^{*} Represents a civil war since 1990

Source: Ross (2003)
Therefore, two country case studies i.e. Nigeria and Botswana are examined in order for Ghana to learn from their experiences. Nigeria and Botswana were of special interest in this study because Nigeria is highly dependent on oil and has mismanaged its oil revenues and had political instability while Botswana though highly dependent on diamonds has managed its revenue well which has led to economic growth.

Nigeria has suffered political instability, corruption and poor macroeconomic management as a result of oil dependency. Table 1 above shows that Nigeria's oil dependency ratio is 39.9 percent Nigeria discovered its oil and gas resources in 1956 and the government was in control of the resources. Before this oil discovery, Nigeria enjoyed the 1950s agricultural boom. It was an agro-based economy with agriculture contributing 64 percent of GDP. Some of its major exports included cocoa, groundnuts, palm oil and rubber. However after the 1970s oil boom, oil exports increased while agriculture exports were neglected. The oil revenues led to an increase in government expenditure, wage rates and an appreciation of the real exchange rate. Nigeria's loans increased from US $1 billion in the 1970s to US $33 billion by 1991 (Abuka et al 2007).

Nigeria experienced fiscal deficits and large public spending that enhanced macroeconomic volatility during the oil booms. Nigeria public spending was quite high, the budget deficit increased from the 1970s as expenditures were rising higher than the revenues. Since 1975, the budget deficit has remained above 4 percent of GDP. The accumulation of this large public sector debt was due to the irreversible rise in expenditures when oil revenue was high (Menachem et al 2004).

According to Menachem et al (2004) analysis, oil price and oil revenue volatility is transmitted to the economy through public spending. Furthermore, weakness in the fiscal administration of the oil sector in Nigeria may lead to inadequate allocation and collection of revenue for the government and that lax audits from the oil companies seem ineffective.

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Figure 1: Dependency ratios for resource dependent countries

Source: Ross (2003)

3 See detailed table 2.4, pp.21 of resource dependent countries in the world.
4 Mineral dependence is the ratio of non-fuel mineral exports to GDP
5 Oil dependence is the ratio of oil, gas and coal exports to GDP
Oil rich Nigeria has a capital-intensive oil sector, which provides 20 percent of GDP, 95 percent of foreign exchange earnings and 65 percent of budgetary revenues. In addition, the agricultural sector only comprises of 17.3 percent of GDP while the industry and service sector constitute 53.2 and 29.5 percent respectively (CIA, 2007,b). Despite all the oil revenues Nigeria gets, 60 percent of the population still lives below poverty line. Corruption, mismanagement of oil reserves and lack of diversification in the export sector could have a big role to play in the slow economic growth and high poverty levels. Nigeria had an oil fund in the past years but the practice was discontinued because of the embezzlement of the funds (Menachem et al 2004).

Unlike Nigeria, Botswana has maintained one of the highest growth rates since independence in 1965 and transformed itself from one of the poorest countries in the world to a middle-income country with a per capita GDP of more than $11,000 in 2006 (CIA, 2007,a). Botswana discovered diamonds in 1966 however exploitation did not commence until the 1970s. The sustained economic growth is largely attributed to diamond mining that constitutes 33 percent of GDP and 70-80 percent of exports and 95 percent of government revenues (CIA, 2007,a). Several factors have contributed towards Botswana's success.

Good governance and transparency have played a big role in ensuring sustainable economic growth. Botswana set up National Development Plans (NDPs) to articulate government policies and development priorities. The good fiscal discipline has kept government expenditure from growing as fast as government revenues in the long run. In addition Botswana has been consistent in free market principles, pro-growth policies and strategies in minerals, land, agriculture and social development (Mogae, 2005).

In Botswana, private companies operate most of the mining ventures, although the government of Botswana has a significant share holding (Modise, 2000). This has helped prevent cases of corruption and misuse of economic rents. The returns from the mining have benefited the economy of Botswana. The revenues have been used to develop the infrastructure, human resources and have helped build up foreign exchange reserves.

IV. OIL AND GAS GOVERNANCE IN AFRICA

In order for African countries to use oil and gas for development, it is important to strengthen governance (Van der Veen 2006). It is argued that the basic framework for oil and gas development is a robust petroleum law. Such a law is required to ensure proper governance. The World Bank has been one of the key institutions assisting African countries to develop and establish resources laws. Such laws define the roles of the state, establish key institutions, describe the basic licensing and contractual framework and set the outline of the fiscal regime, in addition, such a law defines the relationship between the oil and gas laws with other existing laws. While countries such as Sao Tome and Principe have established the required laws, in most African countries, the laws remain inadequate and difficult to change.

The institutional framework also need substantial improvement in Africa in order to ensure successful exploitation of oil and gas resources. Institutions are important because they define how governance is conducted. Countries require assistance to establish strong overseer ministries, national oil and gas companies and accompanying regulatory agencies. Building national capacity in key government institutions has been shown to be important in Angola and Nigeria essentially because the best staff are often taken from government institutions and while international financial institutions such as the World Bank may provide technical assistance when required, it is often difficult to measure the effectiveness of such technical assistance in the oil and gas areas.

Transparency in the management of oil and gas revenues has been shown to be an important attribute. Subscribing to the principles of the Extractive Industries Initiative (EITI) is one means of ensuring success in Africa. Already 8 oil and gas producing countries in Africa namely Cameroon, Chad, Congo, Equatorial Guinea, Gabon, Mauritania, Nigeria and Sao Tome Principe subscribe to this initiative. However, a number of key issues remain because progress varies greatly by country and civil society involvement has tended to be problematic.

Revenue management remains critical because oil and gas revenues require special policies to deal with windfalls. Excessive revenues can lead to corruption and Dutch disease. In addition, due to volatility, revenues tend to fluctuate sharply with oil prices. The
solution has typically been to set up an "Oil Fund" that is separate from the regular government budget. Examples of countries in Africa that have set up such a Fund include Sao Tome & Principe, Angola and Chad. The key issues relate to the need for strong political authority and consensus to establish the Oil Fund early in the oil development cycle.

The challenge of governance in African oil and gas sectors remains huge despite some progress that has been registered by some countries. Going forward, significant improvements in governance will be key to harnessing the large projected revenues for the sustainable development of the continent. Indeed, EITI remains the only viable continent-wide governance initiative on oil and gas that countries should subscribe to. Ghana’s draft oil and gas policy has some good initiatives, however like the other African members of EITI, there will be need to go beyond the current content of the initiative to include issues of transparency in expenditure and revenue management as well.

V. LESSONS FOR GHANA

How does Ghana turn its recently oil and gas revenues into a blessing rather a curse? Macroeconomic issues and governance have a great role to play in ensuring that Ghana’s oil revenues lead to economic growth and sustainability. Nigeria an oil producing country faces many challenges mainly foreign exchange in flows, oil revenue volatility and the fact the oil is an exhaustible resource. In addition, Nigeria has political instability due to dependence on petroleum resources. Out of 50 years of existence since independence, the military ruled Nigeria for almost 30 years. To avoid the same mistake, Ghana should have a well defined laws and policies to prevent the re-occurrence of military rule in Ghana and even civil wars. Some possible options:

a) Maintain adequate reserves

With buoyant oil prices, oil export lead to large fiscal revenues and if not well managed, result in boom burst cycles. Therefore, good macroeconomic management policies would help prevent mismanagement of revenues. In order to improve macroeconomic management, Ghana should be encouraged to accumulate reserves to protect herself against the next negative oil price shock. Long term sustainability of fiscal policy should also be encouraged. (Menachem et al. 2004) In addition, the Ghanaian government could set up policies to prevent conflict and corruption as a result of oil revenues.

b) Diversifying the export sector

Since Ghana is likely to export oil in the near future, it could consider diversifying its export sector and not fully depend on oil revenues. Diversification might also help a country safeguard against revenue shortfall especially since oil is a non renewable resource. For example, Nigeria was an agro based economy before the discovery of oil. However, after the discovery oil it became a net food importer and has since experiences serious political instability. In addition the government could establish other long term assets to guard against the future short fall of revenues.

c) Extractive Industries Initiative (EITI)

Transparency in the management of oil and gas revenues has been shown to be an important attribute. Subscribing to the principles of the Extractive Industries Initiative (EITI) is one means of ensuring success in Africa. Going forward, significant improvements in governance will be key to harnessing the large projected revenues for the sustainable development of the continent. Indeed, EITI remains the only viable continent-wide governance initiative on oil and gas that countries should subscribe to. Going forward, there will be need to go beyond the current content of the EITI to include issues of transparency in expenditure and revenue management as well. Improved transparency could reduce the risk of conflicts and political instability. Botswana has not experienced political instability and has maintained economic growth partly because of good fiscal policy and transparency. Transparency would help prevent any re-occurrence of civil wars and improve management of any upcoming oil revenues. To enhance transparency and accountability, the IMF recommends the integration of oil sector related fiscal activities in the central government budget (Menachem et al 2004:).

d) Public private partnership in ownership

Ghanaian Government could also encourage both public and private partnerships to avoid corruption and civil wars. The sole ownership of oil companies by government might lead to political instability like Nigeria and full private ownership may lead to exploitation. Therefore, private-public partnerships seem to be more efficient and more likely to prevent unnecessary political instability.

e) Be aware that oil and gas revenues are volatile

Oil and gas revenues are very volatile compared to other export commodities due to market conditions (Menachem et al 2004). The foreign
exchange inflows from the oil revenues could affect macroeconomic stability and the economic structure. Frequent adjustments of fiscal expenditures can be costly therefore; good fiscal policy is needed to protect the economy from volatility of oil revenues. Volatility of oil revenues can be reduced through creation of financial assets from fiscal surpluses as precautionary savings and interest income would in turn reduce the overall volatility in government revenue. Volatility could also be reduced through hedging against oil price fluctuations on international commodity exchange (Menachem et al., 2004).

f) **Manage the likely appreciation of the exchange rate**

Oil production is capital intensive and this increases foreign exchange inflow. Excessive foreign exchange inflows could lead to an appreciation of the exchange rate that could in turn lead to a lack of competitiveness in the non-oil tradable sector. This is what is sometimes referred to as the Dutch disease. Menachem et al (2004) argues that the economic structure would then shift from the production of tradable goods to non-tradable goods, which would lead to a rise in import goods. It would be wise for the government to accumulate savings that would help prevent the over appreciation of the Cedes. One method to prevent real exchange rate appreciation, is to design government policies that encourage private sector saving, reforms on pension and banking system, greater reliance on indirect taxes and business profit taxes could be implemented. In addition, fiscal policy should aim at accumulating savings in the form of foreign financial assets in years with high oil revenues, which could then serve to finance deficits in years with revenue shortfalls.

g) **Ensure durable financial investments**

Olters (2007) argues that most Sub-Saharan oil producing countries cannot maintain their fiscal position after the depletion of oil reserves regardless of increase in oil prices and a respectable real rate of return on the financial assets. He advises that governments need to devise effective financial investment strategies to overcome institutional obstacles. They also need to implement structural reforms aimed at increasing the productivity of public investments to stimulate growth and increase the suitable level of government expenditure. Governments should ensure that non-oil taxes don’t fall as a share of non-oil GDP for reasons other than changes in tax policy.

h) **Ensure prudent management of public expenditure**

Governments could use their revenues to finance public expenditure rather than financial assets and to reduce taxes to eliminate distortions and disincentives. This is important for countries where there is great need to build infrastructure and provide essential services. (Menachem et al/2004) Improvement of infrastructure and public services would improve productivity and help reduce poverty in Ghana.

Other considerations for Ghana to learn from Nigerian experience includes Petroleum Industry Bill (PIB) - The petroleum Industry Bill is intended to reposition Nigerian oil and gas industry and ensure investment and transparency in the oil sector. The bill will lead to the incorporation of the Nigerian National Petroleum Corporation, NNPC as a limited liability company. In this case, the company would be subjected to the regulatory power of the upstream regulators. It will establish clear principles of the working of the incorporated joint ventures and guarantee that government continues to secure the maximum benefits from its investment in the joint ventures while relieving government of the problem of 10 percent of the crude oil revenues been provided for the host communities. With this type of arrangement the oil and gas operators would be relieved of carrying out their corporate social responsibilities project while the host communities would have a huge sense of belonging.

The bill will also legislate against unimpressive and non profitable leases that are usually awarded to indigenous and marginal field operators. This will encourage growth of individual companies up to a threshold of about 50,000 barrels per day. Nigeria’s long term energy security depends on her ability to deliver petroleum products in domestic market at cost effective prices. Deregulation is one of the issues that the petroleum industry bill would address which Ghana can from the on set emulate.

### VI. Conclusion

Despite the fact that oil dependent Sub-Saharan African countries face a number of constraints, Ghana has an added advantage of learning from other countries’ experiences to achieve sustainable economic growth. Oil revenues can indeed become a blessing rather than a curse. With improved macroeconomic and fiscal policy, Ghana should be able to fully enjoy the benefits of oil reserves. This could in turn lead to economic growth and sustainability.
The fact that most developing oil producing countries have not achieved the full benefits of being an oil rich country, more research needs to be done on oil and gas exploitation in Ghana to enable government to devise means of benefitting from the oil reserves. The government needs to implement adequate macroeconomic policies and the required political actions to avoid corruption and resource driven instability.

In order for Ghana to use oil and gas for development and avoid conflict, it is important to strengthen governance. The basic framework for oil and gas development is a robust oil and gas law. Such a law will ensure proper governance because it will define the roles of the state, establish key institutions, describe the basic licensing and contractual framework and set the outline of the fiscal regime, in addition, such a law will define the relationship between the oil and gas laws with other existing laws.

In a nutshell, the institutional framework for oil and gas exploitation in Ghana needs to learn from world best practice cases to ensure successful exploitation of these resources. A strong institutional framework is necessary to define how governance is conducted. Building national capacity in key government institutions and departments will be required to ensure continuity.

Transparency in the management of oil and gas revenues has been shown to be an important attribute. Subscribing to the principles of the Extractive Industries Initiative (EITI) is one means of ensuring success for Ghana.

The management of oil and gas revenue will be critical because special policies are needed to deal with windfalls. Excessive future revenues could lead to corruption and Dutch disease. In addition, due to volatility, revenues tend to fluctuate sharply with oil and gas prices. The solution may be to set up an "Oil and Gas Fund" that is separate from the regular government budget.

There should be at least 10 percent of Crude oil revenue provided for the host community which will go a long way at assuaging the feeling of the communities.

The challenge of governance in Ghana’s oil and gas sectors is huge, but there are a number of best practice cases to learn from. Going forward, significant improvements in governance will be key to harnessing the projected revenues for the sustainable development of the country. Ghana needs to subscribe to the EITI because this remains the only viable continent-wide governance initiative on oil and gas, Ghana’s draft oil and gas policy has some good initiatives, however like the other African members of EITI, there will be need to go beyond the current content of the initiative to include issues of transparency in expenditure and revenue management as well.

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