Do Oil and Democracy Mix?

Africa's oil boom promises several countries much needed revenues, but the use of these revenues to further the common good depends on the development of transparency, accountability and good governance.

by Ian Gary

Over the next decade, oil-rich governments in sub-Saharan Africa will receive well over US$200 billion in revenues from petroleum production. Long-standing producers, such as Nigeria, Angola, Gabon and Congo-Brazzaville, are reaping the windfall from record-breaking world oil prices alongside newcomers, such as Chad, Equatorial Guinea and Sudan. A major challenge for Africa's democratic development in the coming years will be to manage this wealth in a transparent way, ensuring it fosters development that benefits the poor.

Africa's oil boom

With declining production in Europe and North America and dwindling opportunities for foreign investment elsewhere, multinational oil companies have begun a new "scramble for Africa." By the end of this decade, over US$50 billion will be spent on African oil fields—the largest private investment in African history. Exploration continues across the continent, and production is expected to nearly double by 2010 to 7 million barrels per day.[1] Encouraging and protecting African production has become a significant issue for U.S. diplomats and military planners, as the United States may soon be buying 25% of its petroleum imports from the region.

The so-called "extractive industries"—oil, gas, diamonds, gold, and other valuable minerals—dominate Africa's trade with the rest of the world. However, the rents derived from oil production are much larger than those for other minerals, and most of Africa's petro-states derive 60-90% of government revenue from this one source. This reality has serious implications for democracy, governance, human rights and development.

The promise and the peril

The new African oil boom is a moment of great opportunity and great peril for countries beset by widespread poverty. New resources will be available for economic development, but the dramatic development failures experienced by most oil-dependent countries reveal that petrodollars have not helped developing countries reduce poverty. In many cases, they have actually exacerbated it. The "paradox of plenty" or "resource curse" are phrases academics use to describe the tragic gap between the promise of petroleum and the perversity of its performance.[2] Studies demonstrate that countries whose leading export is oil have performed worse than other developing countries on a variety of economic indicators.

What are the implications of oil wealth for the development of democracy? Oil revenues profoundly impact economic and political power in Africa's petro-states. Because the petroleum industry requires significant capital, knowledge, skills and technology, only the biggest players, either multinationals or states, are able to exploit this resource. At the same time, because profit margins are so huge, the rents generated by oil generally overwhelm all other revenue sources. Thus, oil-led development has a strong tendency to concentrate both production and revenues in the same hands; too often this occurs in countries (and this is true for Africa) where economic and political power is already very concentrated. The result is that only those who control political power can grant the opportunity to make money from oil, and only those who receive this opportunity can generate the revenues necessary to keep regimes in power. Thus a partnership of mutual interest (though often fraught with tensions) is created.

The result is what economists call a "vicious" development cycle based on rent-seeking (or the attempt to capture petrodollars through unproductive or even corrupt means). In oil-exporting countries, all actors (whether public or private, domestic or foreign) have overwhelming incentives to seek a relationship with the state in order to make money. In turn, governments reward their supporters by funneling petrodollars, tariff protections, contracts or subsidies their way. In the end, productive economic activity is actually penalized, growth is hindered, and economies become distorted. Political power can be sustained only as long as oil revenues flow.

In the Niger Delta, oil money has funded infrastructure im
boy must collect water using a bucket as the new pump

Oil rich, dirt poor

The difficulty of managing oil revenues well in developing countries is compounded by several factors, of which the most important is the lack of transparent political institutions necessary for counteracting rent-seeking. Key elements of democratic governance (accountable executives, efficient civil servants and tax authorities, independent legal systems, active and informed civil societies, and open and transparent policy-making processes) are simply not in place. Business transactions thus lack transparency yet investments and lending continue to pour in without restrictions, resulting in rent-seeking and corruption. Furthermore, because governments have no need to tax the population to keep functioning, an interdependence between the government and the governed is severed—in essence, there is neither taxation nor representation. Over time, earnings are squandered, a precious asset is depleted and widespread poverty remains.

Long-time African oil producers have been largely unable to convert their oil wealth into broad-based poverty reduction. In Nigeria, where the government has received over $350 billion in oil revenues over the last four decades, the majority of the population still lives on less than $1 a day. In Angola, wracked for years by a civil war fuelled by oil and diamonds, a large part of the population depends on international aid for survival while the country is awash in oil revenues. Petroleum has become a magnet for conflict and, in some cases, civil war. Recent discoveries of oil have lead to coup attempts and political instability in Equatorial Guinea, Chad, and São Tomé and Principe. Africa's oil-related problems are perhaps more severe than other developing regions given the exceptionally low level of development in the region, the extraordinarily weak political and administrative capacity, and pre-existing problems with human rights, rule of law and democratic development.

Whether countries succeed in "sowing their petroleum"—that is, turning oil revenues into long-term benefits for their people—ultimately depends on the quality of public policy, democratic institutions and citizen oversight.

Transparency: a necessary first step

Such grim development results are not inevitable. Resource booms can be detrimental, for sure, but they can also be beneficial. Norway has used the benefits from North Sea petroleum to earn the highest place on the United Nations Development Programme's list of best development performers. Thus, the country where people live best, according to a wide range of economic indicators, is an oil exporter. The development problems associated with petroleum are clearly not inherent in the resource itself.

What determines whether the poor will benefit over the long run from oil exploitation is how revenues are raised, what percentage remains inside the producing country, and how these revenues are utilized. Whether countries succeed in "sowing their petroleum"—that is, turning oil revenues into long-term benefits for their people—ultimately depends on the quality of public policy, democratic institutions and citizen oversight.

A first—but by no means sufficient—step towards using oil revenues to reduce poverty and build democratic politics is to create transparent systems for managing, budgeting and distributing oil revenues. Oil is a natural resource owned by all Africans. Nevertheless, many aspects of Africa's oil industry are shrouded in mystery; and key facts about oil are often treated as state secrets. Thus, it is difficult, if not impossible, to track how much money is being generated or how these revenues are spent. Transparency depends on oil companies publishing what they pay governments, and governments revealing what they spend. (In most countries, contracts between oil companies and governments are shielded by confidentiality clauses.) Until information about revenues and contracts are publicly available, civil society groups cannot play a useful watchdog role.

nprovements, like a water pump for this well. But as the village chief drives past in his new Mercedes, a has fallen into disrepair.

Sven Torfinn / Panos

Opening the books

In the last few years, there have been growing demands from African citizens, NGOs, churches and other civil society groups to "open the books" on oil revenues. These demands have gained support from the international civil society "Publish What You Pay" coalition, which includes over 270 groups in dozens of countries, such as Catholic Relief Services, CARE, Save the Children, Oxfam, Human Rights Watch, Global Witness, Friends of the Earth and many others.[3] Local campaign coalitions in Congo-Brazzaville, Nigeria and Chad have been at the forefront in calling for increasing transparency in the management of oil wealth. In several countries, the Catholic Church has been instrumental in breaking the silence over the once-taboo question: where is the money? In 2002, the Catholic Bishops of Central Africa issued a pastoral letter on oil and poverty in the region, saying:

> *"Complicity has come into play between our political power holders and the oil companies. There is absolute secrecy in the elaboration and signing of contracts. Revenue drawn from oil exploitation strengthens state authority, which is used to the detriment of the population. Enriched by oil dividends, the political power holders consider themselves independent of the people, to whom they no longer feel obliged to render any accounts…oil, like other natural resources, has served...to maintain the regimes that give preference to personal interest to the detriment of the common good."*[4]

Breaking the resource curse in Africa?

Growing civil society and media attention to the problems associated with Africa's resource wealth have prompted international actors to respond—though tentatively—to the "paradox of plenty." The World Bank, after a three-year review of its lending in the extractive sector, has agreed to require revenue disclosure of any new extractive project it funds. The IMF has made revenue disclosure a key condition in its negotiations with Angola and Congo-Brazzaville and recently published a "Guide on Resource Revenue Transparency," outlining a best practice system for managing natural resource wealth.

World Bank

Oil pipes run through a rural area in Madagascar.

The increased scrutiny has resulted in some tentative but hopeful changes. In 2004, Congo-Brazzaville published information on its oil revenues, posted contracts on its national Web site, and published the results of the audit of the state oil company. Chad has begun implementing an oil revenue management system (though significant transparency gaps remain).[5] And São Tomé and Príncipe, which will soon start producing oil, has adopted a revenue management law with strong transparency provisions and published the first payments it has received from oil companies.

The Extractive Industries Transparency Initiative

Northern governments, such as the United States and the United Kingdom, are beginning to acknowledge the need to address the perils of oil-led development. In 2003, the U.K. government launched the Extractive Industries Transparency Initiative (EITI), a voluntary program designed to encourage the publication of revenue data by governments and corporations.[6] However, since its launch two years ago, there has been little concrete progress in resource-rich developing countries as a result. EITI relies on the political good will of countries to agree to publication, and it does not address the issue of contract transparency. EITI is being "implemented" in Nigeria, which has hired auditors to examine oil receipts for the past five years, but Angola, Africa's second largest producer, has declined to participate. Equatorial Guinea plans to implement EITI, but this may be difficult in a country with severe problems with human rights and no viable civil society. Finally, voluntary commitments need to be transformed into binding legislation in Nigeria and elsewhere to solidify transparency practices.

Meeting the challenges

Actions such as EITI, while welcome, are not enough. Because developing fields and building pipelines happens faster than the construction of efficient states and good governance, only a sustained, coordinated and coherent international effort—a big push by the relevant actors to change the policy environment—can improve the chances that Africa's oil wealth will improve the lives of the poor. Only a deliberate change in the incentive structure surrounding oil can help to ensure that petroleum revenues will be managed for the benefit of all Africans. But transparency alone will not ensure progress in political environments where the rule of law is violated, human rights are not respected, the independent press is under threat and democratic processes are non-existent or deeply flawed.

Professionals involved in democracy building must pay particular attention to the corrosive effects of oil wealth on democratic institutions and the obstacles it poses to democratic development. More support needs to be funneled to civil society's efforts to monitor oil revenues, track expenditures and inform local populations. Northern donor governments need to explicitly tie diplomatic engagement and bilateral support to measurable progress toward increasing political space, democratic governance, and respect for human rights and the rule of law. The World Bank and IMF need to require demonstrated progress on revenue transparency and demand published audits of oil revenues prior to providing additional support. And oil companies need to help break the system of secrecy by publishing what they pay African host governments.

Unless the main players in the oil story make specific policy changes, Africa's oil boom is unlikely to foster any significant poverty reduction or contribute to democratic development. Instead, oil riches will continue to fund corruption, mismanagement, environmental destruction, human rights violations and conflict. It is urgent that improvements be made now to emphasize transparency and fairness, the construction of capable and accountable institutions, respect for human rights, and the promotion of democracy in oil-producing countries. daL

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Notes

1. By comparison, Saudi Arabia, the world's largest oil producing country, produced 9.95 million barrels per day in 2003. (Statistics from U.S. Dept. of Energy, www.eia.doe.gov)
2. See Ian Gary and Terry Lynn Karl, *Bottom of the Barrel: Africa's Oil Boom and the Poor* (Catholic Relief Services, June 2003), www.crs.org/africanoil.cfm or Terry Lynn Karl, *The Paradox of Plenty: Oil Booms and Petro-States* (Berkeley: University of California Press, 1997) for an expanded analysis of the effects of the resource curse.
3. www.publishwhatyoupay.org
4. *The Church and Poverty in Central Africa: The Case of Oil*, ACERAC, July 2002.
5. See Ian Gary and Nikki Reisch, *Chad's Oil: Miracle or Mirage?* (Catholic Relief Services and Bank Information Center, February 2005), for an extended analysis of this experiment in oil revenue management. www.crs.org/africanoil.cfm
6. www.eitransparency.org