Amount because it provides the liquidity gap created by a shortfall in revenue collections within the fiscal year either due to price or production fall. This means that the revenue management model favours substantial current spending. This might be due to the development challenges faced by the country. For example, the World Bank Infrastructure Diagnostic Report puts Ghana’s infrastructure finance deficit at US$2.3 billion for the next decade.

What remains problematic however is the rate at which the Stabilisation Fund will be built. With the high levels of fiscal deficits in Ghana’s budgets, and the tendency to allocate about 70% of benchmark revenues to the budget, a slower build-up of the Stabilisation Fund may not create significant stabilisation reserves in the event of a significant fall in oil prices, which will subject the Ghanaian economy to unanticipated volatility in the oil market. Ghana can get out of this dilemma in two ways. First, the country could postpone the spending of oil revenues for 2011 and save the money in the Stabilisation Fund to build sufficient reserves before subsequent allocations to the budget. Second, the country could allocate smaller percentage of benchmark revenues (for example 40 – 50%) to the budget for the first few years of oil production and leave substantial balance for savings in the Stabilisation Fund.

Another problem is with the fiscal rule itself which favours current spending as opposed to future spending. Even if the entire annual revenues are allocated to the budget, it may not exceed 10% of GDP which makes Ghana less dependent on oil. Revenues may only clear the deficits without actually delivering tangible benefits to the country in terms of economic growth and development. Therefore, any fiscal rule for managing oil revenues must not see oil revenue as performing magic in the economy but must be seen as creating a fiscal space to correct the fiscal challenges of the non-oil economy. This will require allocation of oil revenues based on sustainable fiscal benchmarks such as the Non-Oil-Primary-Deficit (NOPD).

7.0. POLICY RECOMMENDATIONS

Fiscal policies require discipline to implement. Ghana must therefore work to improve the public financial management system especially the budget processes, the Bank of Ghana Act and the Financial Administration Act must be improved to ensure proper public tracking of revenues and expenditures. Particularly, if Ghana adopts a Fiscal Responsibility Law, citizens can monitor to ensure compliance.

Another measure is to adopt a prudent fiscal policy around a sustainable path for the non-oil fiscal deficit over the medium-term. This is to avoid the Dutch disease effects, volatility effects of oil prices and introduce fiscal discipline especially regarding excessive spending and borrowing.

8.0 CONCLUSION

There is no doubt that oil revenues will provide fiscal relief to the Ghanaian economy. However, it requires sound fiscal policies to ensure the prudent and sustainable utilisation of these resources. The country must recognise that many countries in the developing world with abundant natural resource wealth have not been able to turn this wealth into lasting benefits for their people and Ghana may not be an exception if its new-found wealth is not used to diversify the economy and build appropriate capital to support short-term and long-term growth of the economy. The country also needs to strengthen its institutions and enhance transparency in the management of public resources. This ensures public confidence-building in the overall public financial management system and reduces the governance risks associated with managing natural resource wealth; a situation which has become very essential if Ghana is to escape the ‘curse’ of oil.

Mohammed Amin Adam

FISCAL POLICY OPTIONS FOR MANAGING AN OIL ECONOMY

1.0. INTRODUCTION

The poor economic performance of most natural resource rich countries in the developing world has raised doubts regarding the usefulness of these resources. In development literature, some have described this phenomenon as ‘resource curse’ or ‘resource trap’. The ‘resource curse’ phenomenon in its simplest form refers to the inverse relationship between economic growth and dependence on natural resource revenues. However, it takes other forms including environmental degradation, political instability and the corruption of the political system. This phenomenon has occurred repeatedly in countries with resource wealth.

For example studies have shown that countries that are resource poor grew four times more rapidly than resource rich countries. Other studies show that countries that are dependent on oil exports have performed worse than their resource poor counterparts; they have also performed far worse than they should have, given their revenue streams. However, it is not the endowment of these natural resources that is a problem but rather its management. A number of factors are responsible for the resource curse syndrome.

One factor is that oil revenue inflows can hurt other sectors of the economy through real currency appreciation which then renders other exports non-competitive — a phenomenon called the Dutch Disease. The Dutch Disease takes different forms. The first, called the ‘resource effect’ relates to mobility of factors of production from non-oil sectors to the oil sector. This raises factor prices in the oil sector and thereby contracting other sectors (Fardanesh, 1991). For instance, McMahon (1997) reports that oil booms result in a shift of both labour and capital inputs to non-tradables.

The second - the ‘spending effect’ describes increased use of revenues accruing to exporting countries from oil exports. The ‘spending effect’ is of the view that with increased resource revenues, aggregate demand rises in both tradables and non-tradables. Prices of the tradable sector are determined by the international market, whereas the non-tradables sector prices then go up and thereby moving resources to non-tradables from the tradables sector (Corden and Neary, 1982).

Another factor is that the long-term price deflation and price volatility of the international primary commodities market usually obstruct the development path. Oil prices in particular have been very volatile over the years especially since the 1970s. This situation has subjected the economies of resource rich countries and their budgets to extreme economic shocks which sometimes trigger economic adjustments that have become too costly for these countries.
countries. The fiscal indiscipline that has accompanied adjustments to booms has also undermined economic prudence and “good” investments. The results have been the persistence of planned programmes, poor income distribution and poverty reduction.

Another significant cause of “resource curse” is attributed to the enclave nature of the resource industry. Oil is the world’s most capital-intensive industry and with weak linkages to the rest of the economy.

Ghana is expected to receive oil revenues from 2011 and this could continue for the next 20 years and beyond. The country’s fiscal outlook however still shows serious challenges as it is confronted with fiscal deficits, lowering foreign donor inflow, economic development targets such as the Millennium Development Goals and its other income targets as well as weak institutional frameworks including weak budgetary processes. Ghana has however progressed in its democratic governance which is also threatened by the oil boom. Whether the management of expected oil revenues will help Ghana avoid the “resource curse” or create fiscal sustainability to meet its fiscal and development challenges should be serious concerns for the managers of the economy.

2.0. GHANA’S FISCAL OUTLOOK

Ghana’s fiscal performance has largely been mixed; with periods after elections recording the worst performance. Different reasons have been given over the years for this phenomenon including the fall in the global prices of Ghana’s primary commodities such as gold and cocoa in 1999 and the increased global prices of crude oil and food between 2007 and 2008.

However, the fact that these fiscal slips occurred during post-election periods cannot support the argument of global shocks being the only cause of this situation since shocks are time-neutral. In fact, the stabilization of the fiscal downturn in 2008 according to the 2009 budget of the government included increased government expenditure as a result of the good performance of the revenue collection. Public expenditures, for instance, grew to reach 41% of GDP in 2008 from 37% in 2007 and 34% in 2006. But this was non-proportional with the growth in revenues. This practice which is known as “budget illusion” was compounded by the country’s move to the capital market to raise US$750 million which was used for budget support rather than build capital to support short-term and long-term growth.

The recent global crisis has also been blamed for Ghana’s fiscal underperformance in 2008 and 2009. Particularly, the capital account was adversely hit through repatriation of capital by investors of about 2% of GDP, whilst remittances from abroad also fell significantly. This also affected Ghana’s international reserve position which fell by more than US$600 million in five months (August to December of 2008) and as a result, led to the depreciation of the Ghana Cedi against the United States Dollar by 16%.

Oil imports continue to take a huge toll on the balance of trade and the budget. The last couple of years saw budget accommodation of higher crude oil prices; a situation which led to the erosion of the prices of petroleum products whilst petroleum subsidies which characterised the period reached 2.4% of GDP in 2008. These measures among others were responsible for the historically-huge fiscal deficit of 14.5% of GDP by the end of 2008 with its negative consequences on macroeconomic stability.

Due to the higher fiscal deficits recorded in 2007 and 2008, GDP growth in real terms was lower. Thus, the growth rate of real GDP and poverty would be reduced, this is reflected on its face-value, without taking into consideration the cost of growth.

Domestic financing of the interventions against the effects of the financial crisis and against fiscal deficits has not been an effective way of correcting deficits. Our history of deficit management indicates that domestic financing policies to increase in the interest rates and through this, crowded out the private sector. For example, after declining from 40% in 2000 to 18% in 2004 bringing about a significant growth in credit to the private sector, interest rates went up again following the instability in 2007 and 2008. The Treasury Bill rate, for instance, went up to 25% by April 2009.

Net financing of the deficits between 2006 and 2008 were consistently huge. Fiscal deficits consistently ate into 9.4% of GDP. The reduction in net financing in 2009 and 2010 has however been done at the expense of economic growth since it was backed by significant fiscal adjustments and increased domestic revenues. The country also received support from the IMF and the World Bank, part of which went to external sector support to stabilise the local currency.

The Government of Ghana has set a medium-term fiscal framework to reduce fiscal deficits from 14% in 2008 to 2.11% of GDP in 2014. Whether these fiscal targets are achievable or not, will depend on a mixture of fiscal policies which should take into consideration demand management, efficiency spending and revenue volatility.

The World Bank in a report released in 2009, observed that fiscal stabilisation would likely bring down real economic growth before the commencement of oil production. Official Development Assistance is also likely to scale down as a result of expected oil revenues, and with low Foreign Direct Investments, real growth will decline further. Thus, production of oil in Ghana and the expected revenues from oil do not only provide the economy a financial relief but also threatens economic performance, making Ghana a potential candidate for ‘resource curse’.

Debt vulnerability is likely not to get better in spite of the oil revenues. A Preliminary Debt Sustainability Analysis undertaken by the World Bank based on Ghana’s debt profile in December 2008 and the macroeconomic framework for 2009-2011, suggests that the medium-term risk of debt distress would not significantly increase. In addition, the Bank observed that the attempt to borrow on non-concessional terms against future oil revenues for fiscal consolidation would even worsen the risk of debt distress. The large fiscal deficits the country enjoys now are also likely to take Ghana to unsustainable debt levels. This might be the reason for the failure to pay off public debts and put the economy on a fresh start.

3.0. OIL REVENUES AND THE FISCAL SPACE

With government oil revenues estimated at US$20 billion for the next 20 years, assuming a crude price of US$75 per barrel of oil and a production of 500 million barrels of crude oil, being the first phase of Jubilee, Ghana could earn an average of US$1 billion per year (World Bank, 2009).

These revenues will create a very important fiscal space for the emerging oil economy to meet development objectives of Accelerated Growth and Poverty Reduction, and provide fiscal space itself does not address the social and economic challenges of a country if appropriate fiscal policies and rules are created within the framework of broad public financial management. Despite this, it is important to note that oil resources are also deleterious. Therefore, it is within the fiscal space expected to be created by oil revenue inflows, the country might also pursue fiscal sustainability to cushion the economy against volatility effects and economic underperformance when the country’s oil is depleted.

4.0. ALTERNATIVE FISCAL RULES

Different fiscal rules may be required to address the fiscal challenges the country is likely to face as it receives oil revenues. The two extreme rules are the balanced-budget rule or what is commonly called ‘hand-to-mouth’ rule, which requires spending all oil revenues that accrue to the state; and the ‘bird-in-hand’ rule, which requires the spending of interest payments on accumulated net financial assets from oil.

The economic difference between these rules is that the hand-to-mouth is good for countries with huge public investments and infrastructure requirements which are required for growth acceleration. It however subjects the budget to revenue variability since oil prices are unpredictable. The bird-in-hand on the other hand favours accumulation of oil revenues and assets for future consumption to satisfy the intergenerational equity argument. This rule accounts for revenue variability but denies the economy of much-needed capital.

There is also the medium-term price rule, under which oil revenues valued at a medium-term price in the budget are spent whilst the balance is saved. This rule is followed by Chile in the management of its Copper Stabilisation Fund. The most popular fiscal rule is the permanent income rule based on the Permanent Income Hypothesis formulated by Milton Friedman. This rule requires that spending should be pegged at levels equivalent to the present discounted value of future oil revenues. The rule does not only ensure intergenerational equity but also accommodates revenue volatility. This rule is used in Saudi Arabia, Brunei and the UK.

5.0. INTERNATIONAL EXPERIENCES ON FISCAL RULES AND FISCAL RESPONSIBILITY LAWS

Some countries have passed Fiscal Responsibility Laws including New Zealand while Nigeria is making significant efforts at introducing fiscal responsibility to solve fiscal challenges. In Norway, the 4% rule is religiously followed whilst in Chile, the permanent price rule is applicable. There are other countries (both resource and non-resource countries) that are making fiscal reforms to ensure fiscal responsibility and sustainability (see Table 1).

6.0. THE PETROLEUM REVENUE MANAGEMENT BILL AND FISCAL POLICY OPTIONS

Ghana’s petroleum revenue management bill does not particularly specify a single rule. In fact, it combines parts of all the fiscal rules. The bill provides for the spending of a predetermined percentage of annual petroleum revenues (annual budget funding amount) whilst the balance is shared between a Stabilisation Fund and a Heritage Fund. The former is required to be spent whilst the balance will be used in line with a 50-70% ratio which provides significant transfers to the budget to meet the development and domestic challenges of the country. The Heritage Fund also addresses volatility concerns whilst the Heritage Fund deals with intergenerational equity.

It is important to note that the Stabilisation Fund is technically a component of the Annual Budget Funding

Table 1 Fiscal Reform Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Fiscal Rules</th>
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<tbody>
<tr>
<td>Austria</td>
<td>The reform of the Federal Budget Law, adopted by constitutional law in 2007, includes the requirement for the government to set up Goal-Year Planning, which is extended annually by another year. These ceilings apply to the federal government and contain a cyclical component. This rule took effect with the 2006 budget.</td>
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<td>Germany</td>
<td>A new structural balance rule was enshrined in the constitution in June 2009. After a transition period, starting in 2011, it will take full effect in 2016 for the Federal government and 2020 for the states. The rule calls for a structural budget deficit of no more than 0.35 percent of GDP for the federal government and structurally-balanced budgets for the Länder.</td>
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<tr>
<td>Hungary</td>
<td>In November 2008, Hungary adopted a primary budget balance rule as a real debt rule as part of the adoption of a Fiscal Responsibility Law. The rules take effect in 2012. Transition rules call for a reduction of the deficit (in percent of GDP) and limit real expenditure growth in 2010 and 2011. A new independent fiscal institution was also established to monitor fiscal developments.</td>
</tr>
<tr>
<td>Mexico</td>
<td>To promote savings, caps on accumulation of revenues in oil funds were removed for 2010. Consideration is being given to (i) introducing a new structural rule to reinforce savings at the top of the cycle and further reduce debt ratios; and (ii) improving medium-term expenditure planning.</td>
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</table>

Source: IMF (2009)