

## Ghana Petroleum Revenue Management Act: Back to Basics

Aisha Adam

Ghana's Petroleum Revenue Management Act (PRMA) has arguably improved the transparency of petroleum revenue allocation. This is borne out by Public Interest and Accountability Committee (PIAC), Ministry of Finance, Ghana National Petroleum Corporation and Bank of Ghana publications regarding how much petroleum revenues are collected and where they go.

However, there are concerns the act has not adequately addressed issues relating to revenue volatility and expenditure smoothing, or contributed to overall fiscal sustainability. Petroleum revenue management in Ghana, guided by the legislation, faces critical challenges. Many complexities in executing and interpreting the PRMA have also caused digressions from the spirit of the act. Therefore, there is an urgent need to go back to the basics to align with the core principles of the PRMA and to identify and consider potential reforms.

This brief highlights some of the implementation challenges of PRMA provisions. It makes recommendations to improve petroleum revenue management in Ghana in the future. This discussion is particularly important for Ghanaians now: the implementation of new social programs like free senior high school ("Free SHS") will rely in part on petroleum revenues and require a sustainable financing plan.

We identify five priorities for the consideration of the Ghana government as it seeks to enhance the country's approach to petroleum revenue management:

- 1 Maximizing transparency of projects funded by the Annual Budget Funding Amount (ABFA) and linking them to a national development plan
- 2 Making benchmark revenue projections serve their intended purpose
- 3 Emphasizing the role of the PRMA in broader public financial management
- 4 Carefully scrutinizing resource-backed infrastructure loans
- 5 Fully empowering the Public Interest and Accountability Committee

### MAXIMIZING TRANSPARENCY OF ABFA PROJECTS AND LINKING THEM TO A NATIONAL DEVELOPMENT PLAN

Most resource-rich countries that have managed petroleum revenue spending well developed strategic plans to guide their expenditure. Botswana, a resource-rich country guided by its National Development Plan, invests its mineral revenues primarily in education and health: these sectors have the potential to generate

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sustainable alternative streams of income for the economy long after the non-renewable natural resources have been exploited. When resource revenues are invested in sectors of the economy where the impact is likely to be great within a relatively short period of time, such investments can help to reduce poverty.

The PRMA provides for spending to be guided by a long-term development plan. However, Ghana has yet to develop such a plan and the selection of ABFA priority spending areas has been insufficiently connected to a long-term strategy. Successive ministers of finance have thus selected ABFA priority spending areas based on their discretion since Ghana began producing oil in 2010. As such, these “selected ABFA priority areas” have often faced challenges, because there is not always strict compliance with the selected areas when it comes to disbursing ABFA funds.

A national development plan or medium-term strategic framework would enable the government to more realistically manage the expectations of Ghana’s citizens about the petroleum sector’s contribution to national development. With petroleum revenues contributing an average of 4 percent of the national budget from 2011 to 2016, such revenues are very limited in their ability to contribute to significant improvements in the lives of Ghanaian citizens. A transparent process of determining national spending priorities and outlining how much each sector of the economy would thus contribute would reduce distrust and suspicion that citizens have around petroleum sector management.

Petroleum sector transparency measures can also be improved. The government has consistently published information on allocations to the four ABFA priority spending areas as well as the list of projects being funded. But other critical information remains somewhat elusive. There is still inadequate information regarding the total value of projects that have received petroleum funds; their expected date of commencement and completion; contractor details; and their stages of implementation. This reduces the impact of PRMA-mandated transparency by making it more difficult for citizens to get a sense of the big picture on projects funded by ABFA.

Going forward, future petroleum revenue allocations should be guided by strategic medium-term plans that align with national priorities shaped through public consensus. Also, detailed information on ABFA-funded projects is important. This information might include the list of projects financed by the ABFA and their respective allocations, the project locations, their stages of completion and the contractors executing such projects. This will help make ABFA spending more transparent and ensure that projects funded by the ABFA are in line with national priorities developed through national consensus and enshrined in a detailed medium- to long-term strategic national development plan.

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## MAKING BENCHMARK REVENUE PROJECTIONS SERVE THEIR INTENDED PURPOSE

The benchmark revenue calculation is a critical part of the PRMA. It determines the proportion of petroleum revenues that can be spent and saved at any given point in time. Despite its importance, the benchmark revenue calculation is not well understood by Ghanaian policy-makers and the public. Apart from the calculation's complexity, it has also often been mischaracterized as a projection tool designed to forecast expected petroleum revenues when it should be used solely for determining how much revenue is spent versus saved. In practice, the government

has repeatedly interpreted benchmark revenues as expected revenues in national budget estimates, despite *past* revenues being included in the calculation.<sup>1</sup>

This has muddied public understanding of the difference between benchmark revenues and expected revenues. As a result, public judgement has focused on how the moving average model has poorly predicted petroleum revenues rather than seeing it as a benchmark for budgeting purposes.

Benchmark revenue is calculated using the product of two moving averages:

- A seven-year average of oil prices that includes the past four years, the current year and two forecast years
- A three-year average of the government's take in oil that includes a one-year forecast

Using the moving average calculation for budgeting purposes implies that when revenues are high, the government builds up surpluses, and when revenues are low, there are shortfalls. In this way, the government attempts to smooth expenditure by following a repeated cycle of building up savings and depleting them over time. This expenditure smoothing helps to mitigate the effects of revenue volatility and ensures that government projects are not severely affected when there are revenue shortfalls. The spirit behind the adoption of a moving average is to ensure that government spending adjusts slowly to either a sharp fall or sharp rise in prices. This is why the Ghana Stabilization Fund (GSF) was set up to act as a buffer during shortfalls. However, in the recent past, placing a cap on the stabilization fund has limited the ability of the fund to fully serve its intended purpose.<sup>2</sup> The confusion around interpreting benchmark revenue as projected revenue has forged the basis for government interference in the benchmark revenue approach to dealing with revenue volatility.

It is important that the rules for calculating benchmark revenue are clear and transparent. We believe the government can invest more heavily in communicating to the public that benchmark revenue is estimated solely for budgeting purposes. This would reduce the common misconception that benchmark revenue is synonymous with a government projection.

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## EMPHASIZING THE ROLE OF THE PRMA IN BROADER PUBLIC FINANCIAL MANAGEMENT

The trickle-down effects of poor management of the other sectors of the Ghanaian economy are likely to more than net out the positive effects of the efficient management of petroleum revenues if there are no laws in place linking petroleum revenue management to broader public financial management in Ghana. Ghana's PRMA is focused on ensuring fiscal expediency in petroleum revenue management, without recourse to the other sectors of the economy.

1 See, e.g., Jessica Acheampong, "Govt cuts down oil revenue projections." *Graphic Online*, 26 July 2016, <http://www.graphic.com.gh/business/business-news/govt-cuts-down-oil-revenue-projections.html>.

2 Government of Ghana, *2017 Budget Statement and Economic Policy* (2017), 48.

Petroleum revenues have constituted only about 4 percent of Ghana's annual budget on average since the commencement of oil production. These revenues are also subject to world oil prices, which can fluctuate dramatically and have been low the last few years. *Hence, attempting to manage 4 percent of Ghana's economy efficiently is unlikely to translate into broader fiscal discipline in public financial management.* For instance, in 2014, although the government saved about GHS 1.7 billion in the petroleum funds, it also increased public debt by about GHS 70 billion. Annual interest rates on Ghana's Eurobond debt are in the range of 8 percent, while returns on savings in the sovereign wealth funds have averaged approximately 1.15 percent over the last six years (2011-2016).

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Although the PRMA has effectively delivered improvements in transparency in revenue allocation and utilization, it has faced many broad challenges related to revenue volatility, expenditure smoothing and overall fiscal sustainability. Given petroleum's relatively small role in Ghana's economy, the PRMA alone has not been able to adequately support budget sustainability. As a result of an increasing budget deficit funded through borrowing, even more so since the discovery of oil, Ghana's growing debt and interest payments have caused severe macroeconomic woes for the economy that threaten to worsen in the near future. Since the inception of oil production in Ghana, interest payments on debts have averaged about 5.14 percent of GDP. In 2016 alone, Ghana's interest payments on loans amounted to GHS 10.77 billion, representing 6.4 percent of GDP, and about 29 percent of total domestic revenue collected. This means that for every GHS 1 collected in revenues in 2016, GHS 0.29 was spent on interest payments. In the absence of a public financial management framework with fiscal rules on aggregate borrowing and savings, the public debt has now escalated to over 70 percent of Ghana's gross domestic product. Ghana's worsening fiscal position has contributed to the rapid depreciation of the Ghanaian cedi, escalated inflation and a general decline in economic activities. For instance, Ghana recorded its lowest economic growth rate in 25 years in 2015.

Sections 13 to 17 of the recently enacted PFM law (Public Financial Management Act, 2016)<sup>3</sup> indicate broad fiscal objectives for the government. However, there is no clear information on specific fiscal targets on debt, government spending and taxes. The new government's intention to pass the fiscal responsibility law is a step in the right direction. The law should, however, incorporate robust, specific numerical targets at aggregate and sector-specific levels. Under their structural fiscal balance rule,<sup>4</sup> countries such as Chile, adopted numerical targets and a methodology for execution of those targets.

Chile's structural fiscal balance rule has three components. First, it sets a deficit target assuming the economy is operating at its full potential and the price of copper (the country's main export) is at its long-term level. Second, it sets out a procedure to estimate how far the country is from its target using inputs from independent experts. Finally, it provides the formula for how the target should be reached over multiple years. As a result, the rules allow the government to borrow in bad years and save revenues in good years while maintaining an objective of long-term sustainability.

3 Government of Ghana, *2016 Public Financial Management Act* (2016), 12-15.

4 Jorge Rodríguez C., Carla Tokman R. and Alejandra Vega C. *Structural Balance Policy in Chile*. OECD *Journal on Budgeting*, volume 7 no. 2 (2007): 60.

Peru also has a Fiscal Responsibility and Transparency Law. It establishes a deficit limit and expenditure growth rule. In both Chile and Peru, the legislation also requires an independent body to oversee the execution of the fiscal rule. To be effective, fiscal targets, policies and indicators outlined in the fiscal responsibility law should be aligned with existing rules in the PRMA.

Since Ghana is heavily reliant on primary commodities subject to fluctuating prices, in addition to being an import-reliant economy, it needs fiscal rules for managing aggregate levels of debt, expenditure and savings, as well as rules for managing the same at the sector level. These fiscal rules will help with building up savings buffers to enable the economy to better respond to shocks. Botswana has successfully implemented these rules in a coordinated fiscal framework; Ghana can learn important lessons from Botswana's example.<sup>5</sup>

## CAREFULLY SCRUTINIZING RESOURCE-BACKED INFRASTRUCTURE LOANS

Resource-backed financing is the practice of using a country's resources to serve as a guarantee for loans from international financial institutions and/or governments. In Africa, this practice began in Angola, when Standard Chartered identified and assisted the country with funds to finance its war against Jonas Savimbi's UNITA rebels. At the time, Angola had a low sovereign credit rating, and Standard Chartered agreed to a financing arrangement where funding for Angola's ongoing conflict was guaranteed by future petroleum revenues. By the end of the war in 2002, Angola had subscribed to 48 oil-backed loans.<sup>6</sup> The practice is now commonplace in resource-rich countries in Africa, with banks such as BNP Paribas of France, Commerzbank of Germany, Exim Bank of China, National Development Bank of Brazil and other institutions participating in such loans.

If resource-backed loans are effectively managed within a robust governance context, they may help to generate productive returns. Efficient management of such facilities might also help build much-needed infrastructure for economic diversification of subscriber countries to create multiple streams of income.

Across Africa, governments have struck a growing number of deals with foreign entities using resource revenues as securities to finance infrastructure.<sup>7</sup> But many of these deals have been shrouded in secrecy. For instance, Ghana's USD 3bn loan from China Development Bank (CDB) to help in building the Atuabo gas plant and non-oil-and-gas-related infrastructure has faced many spending, regulatory, tax leakage and oversight challenges.

In Ghana, public investments do not easily translate into commensurate additions to physical capital. There are many reasons why public investment delivery remains weak. For instance, there are often challenges with project appraisal and selection, leading to delays in execution when projects are finally selected.

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5 African Development Bank. *Botswana's Mineral Revenues, Expenditure and Savings Policy: A Case Study*, (2016): 11

6 Deborah Brautigam, *The Dragon's Gift: The Real Story of China in Africa* (Oxford, U.K.: Oxford University Press, 2011) 274.

7 David G. Landry. "Sicomines Deal Offers Four Clear Resource-for-Infrastructure Lessons." *Natural Resource Governance Institute*, 9 March 2017, <http://www.resourcegovernance.org/blog/sicomines-deal-offers-four-clear-resource-infrastructure-lessons>.

The CDB loan faced similar problems. Spending challenges and delays in execution resulted in penalty costs, forcing the government to renegotiate the facility to USD 1.5 billion. Also, deficits in institutional oversight and access to information also limited parliament's ability to properly scrutinize the contracts to ensure that they served the best interests of the nation. Per Ghana's constitution, contracts between the government and foreign entities need to be ratified by parliament, and any taxes to be accrued from such projects also need to be determined by parliament. However, parliament did not have enough information to scrutinize the Atuabo gas contract and its subcontracts and determine applicable taxes for the contractors.

The contracts contained several tax exemptions for the executors where information was not provided for parliamentary scrutiny and approval. By granting tax waivers to the executors without parliamentary oversight, the government of Ghana lost substantial revenues that could have been channeled into the budget to be used in development projects. In addition, the lack of a clear distinction of mandates for Ghana's two energy sector regulators, the Petroleum Commission and the Energy Commission, compromised the ability of these institutions to ensure that internationally acceptable standards were applied in executing the contract. The Energy Commission's mandate gives it the authority to oversee energy related activities in Ghana and the Petroleum Commission mandate gives it the authority to oversee petroleum-related activities. However, in this instance, there was confusion as to which commission had the clear mandate to oversee the Atuabo gas plant: it utilizes gas from the Jubilee field to generate an energy mix due to the overlapping responsibilities over gas inflow to the Atuabo gas plant.

In Ghana's case, the resource-backed infrastructure loan almost equaled total receipts from oil production since inception. The government must ensure absolute transparency in such dealings to ensure that loans are used for their intended purposes. Mandates of industry regulators should also be clearly defined in law and strictly enforced to ensure that there is no duality of roles. This will help make industry regulation more efficient.

In the future, government executives must provide all information required for state institutions to conduct due diligence in approving resource-backed infrastructure contracts. One way of building the capacity of oversight agencies is to provide all applicable information and equip those agencies with tools to effectively scrutinize the information.

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## FULLY EMPOWERING THE PUBLIC INTEREST AND ACCOUNTABILITY COMMITTEE

The role of the Public Interest and Accountability Committee (PIAC) in ensuring transparency in the utilization of petroleum revenues cannot be overemphasized. The PIAC plays a pivotal role in tracking government spending of petroleum revenues and communicating that spending to citizens of Ghana. The government must focus on building PIAC's capacity to deliver on its mandate to the people of Ghana by providing the much-needed financial support to enable the committee to function smoothly. In addition to providing financial support, the government could also collaborate with PIAC to create more awareness on what plans exist for spending petroleum revenues and how these revenues are expected to impact the lives of Ghanaian citizens, especially those living in remote parts of the country.



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A practical way for the government to collaborate with PIAC in improving transparency is through drafting the citizens' budget. The citizens' budget, first published in 2015, did not include information on petroleum revenue. In drafting future citizens' budgets, the government could invite PIAC to work in collaboration to restructure the budgets to incorporate sections on petroleum revenue spending in simple language that ordinary citizens can understand. Information on petroleum revenues accrued and how the revenues have been spent could then be accessed by citizens. This could include the list of projects financed by the ABFA and their respective allocations, the locations of the projects and the stages of completion. In addition, PIAC could draft up separate manuals on an annual basis that use infographics to provide a breakdown of government spending of petroleum revenues for citizens unable to read and write. These efforts could go a long way in motivating citizen interest in how government spends petroleum revenues and improving citizen oversight. This will help the government hold contractors accountable for different projects in the pipeline.

There is still great potential for Ghana's oil and gas sector. The TEN field, which is already onstream, and the Sankofa field, expected to come onstream this year, are projected to provide a boost to government revenues. The rules of petroleum revenue management need to be strengthened to ensure these additional revenues are used more prudently and effectively. Ghana needs strategic national development planning; a strong public financial management framework embodied by sound fiscal rules; and entrenched transparency and accountability provisions. These checks will ensure additional revenues are prudently managed to yield the highest possible returns for the greatest benefit of Ghana's citizens.