Policy brief

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Harnessing Oil Revenues in Ghana

In brief

- The Jubilee oil field, off the coast of Ghana, has started production recently. The Ghanaian economy is characterised by a low-equilibrium state: low income, low physical and human capital and relatively high inflation rates.

- This study attempts to construct an appropriate strategy for harnessing any windfall from oil revenues in Ghana. This involves asking a number of questions, such as, should the government spend or save the oil windfall revenue, and how should it be spent or saved.

- The authors recommend that the Government of Ghana use revenues from oil to alleviate capital scarcity. This will help the country to reduce credit spreads, and thus, stimulate private and pulbic investment and raise wages.

- Another key recommendation is to invest in domestic capital, such as education, health, modernizing agriculture and infrastructure. Ghana's low growth is partly a conseqeuence of its small and slow growing capital stock. Therefore, investing in doemstic assets will help Ghana move along a path of structural transformation.

- Furthermore, investing funds in foreign assets through a sovereign wealth fund should be pursued if there are large absorption constraints in non-traded sectors. This is only useful as a temporary way to stabilize oil volatility and smooth th e effects of 'Dutch disease' and absorption constraints.

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Policy Motivation

Ghana has recently started producing oil from the offshore Jubilee field. We determine the most appropriate strategy for harnessing this relatively small and temporary windfall given the unique characteristics of the Ghanaian economy: low income, low physical and human capital, the start of structural transformation, large stock of foreign debt and relatively high inflation rates.

Policy Impact

We focus specifically on the strategic options facing Ghana's government, once the revenues from oil production have been received. In doing so we address two major questions: first, whether to spend or save the oil windfall revenue, and second, how it should be spent or saved.

"We determine the sensitivity of the permanent income hypothesis to impatience, electoral uncertainty, intertemporal substitution and precautionary motives and, on balance, find that spending should be brought slightly forward."

Audience

Key Ghanaian policy makers in government and politics, especially Bank of Ghana and Ministry of Finance and Economic Planning; civil society; IMF; World Bank; students; researchers.

Policy Implications

Use oil revenues to alleviate capital scarcity

We determine the sensitivity of the permanent income hypothesis to impatience, electoral uncertainty, intertemporal substitution and precautionary motives and, on balance, find that spending should be brought slightly forward. This should primarily be done by alleviating capital scarcity which will help to reduce credit spreads, in turn stimulating private and public investment and raising wages.

Investing in domestic capital

The remainder of the windfall should primarily be used to invest in domestic capital (education, health, modernizing agriculture, and infrastructure). Since Ghana's low growth is largely driven by its small and slow growing capital stock, the optimal spending strategy is to invest heavily in domestic assets during the oil boom. This will move Ghana more quickly along the path of structural transformation. The effects of Dutch disease will largely be subsumed by the broader contraction of the traded sector through structural transformation.

Sovereign wealth fund

Some funds should temporarily be parked in foreign assets if there are large absorption constraints in the non-traded sectors. Investing in foreign assets through a sovereign wealth fund is thus only useful as a temporary way to stabilise oil volatility and smooth the effects of both "Dutch disease" and absorption constraints. However, this should only be pursued once the issues of capital scarcity have been alleviated.

Implementation

"The objective should be to make more room for public and private investment by alleviating capital scarcity"

It is useful to see whether the insights and policy implications can be used to improve the way Ghana's Petroleum Revenue Management Act is used in practice. The objective should be to make more room for public and private investment by alleviating capital scarcity, to identify in which domestic sectors it is most opportune to invest, and to identify the political, legal and organisational lags for each investment project before it can be sensibly and responsibly implemented. There also should be guidelines to supplement the Petroleum Revenue Management Act on whether it is better to temporarily park oil funds abroad until absorption constraints are alleviated.

Further Readings

Andrew Berg, Jan Gottschalk, Rafael Portillo, and Luis-Felipe Zanna (2010). The macroeconomics of medium-term aid scaling-up scenarios. *IMF Working Paper*, Washington, D.C.

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About the authors

Rick Van der Ploeg is Professor of Economics at the University of Oxford, having previously been an academic at the University of Cambridge (1977-1983), LSE (1983-1988), Tilburg University (1985-1991) and the European University Institute, Florence (1988, 2003-7), a Chief Financial Spokesperson in the Dutch Parliament (1994-98), a State Secretary for Education, Culture and Science (1998-2002) and an elected member of the UNESCO World Heritage Committee (2003-7). Currently, also affiliated with CEPR, CESifo, Oxcarre, Netspar, the University of Amsterdam, and the Tinbergen Institute.

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