

Harnessing Oil Revenues in Ghana

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I. Policy Motivation for Research:

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.

II. 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.

III. 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.

IV. 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.

V. Implementation:

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.

VI. Dissemination:

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VII. 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.

Paul Collier, Rick van der Ploeg, Michael Spence and Tony Venables (2010), Managing resource revenues in developing economies, *IMF Staff Papers*, 57, 1, 84-118.

J. Dagher, J. Gottschalk, and R. Portillo (2010). Oil windfalls in Ghana: a DSGE approach, *IMF Working Paper WP/10/116*, Washington, D.C.

Douglas Gollin, Stephen Parente, and Richard Rogerson (2002). The role of agriculture in development, *American Economic Review*, 92(2):160–164.

Rick van der Ploeg (2011). Natural resources: a curse or a blessing?, *Journal of Economic Literature*, 49, 2, 366-420.