

# **MANAGING NATURAL RESOURCE REVENUE FOR SUSTAINABLE GROWTH & DEVELOPMENT**

## **Opening Address by Mr. Alex Ashiagbor, Chairman of the Governing Council, IFS and former Governor of the Bank of Ghana**

### **Introduction**

Mr. Chairman,

Distinguished Guests,

Representatives of the media,

Heads and staffs of the Institute for Fiscal Studies (IFS) and The Natural Resource Governance Institute (NRGI),

Ladies and Gentlemen.

It is a pleasure for me to give the opening address to this unique forum, which brings together key stakeholders in the natural resource sector, as well as representatives of international organizations, government and Members of Parliament on this most timely topic regarding our country's growth and development, namely "The 2016 National Budget- What should we expect".

Let me hasten to explain that although the topic for this morning's gathering is "Budget 2016 Forum: Making the Most of Petroleum Revenues", the main idea here is to examine the challenges and risks, confronting the 2016 budget, what we might expect from the 2016 budget as a result of these challenges and risks, and how we should manage our natural resource revenues such as to address them to contribute to sustainable growth and development of our economy. I understand there will be two panels: The first will deal with: "Recent Fiscal Challenges and Risks"; the second will address the issue of "Making the most of Petroleum Revenues".

This invitation could not have come at a more opportune time. You are well aware of what IFS and NRGI have been doing to promote national discourse on the socio-economic developments of our dear country, Ghana. Forums like this help create the opportunities to discuss and disseminate relevant information about the Ghanaian economy and also contribute to the capacity building of the citizenry. This is the first of many such gatherings

that we hope to see under the joint auspices of the Institute for Fiscal Studies and the Natural Resource Governance Institute. The idea of organizing this event also reflects growing recognition and importance of bringing civil society organizations, business community, development partners, academia, and other institutions together to make inputs into our national budget.

### **Benefits and Opportunities of Natural Resource Endowment**

Mr. Chairman, as you are all aware Ghana is well endowed with natural resources such as gold, diamond, manganese, and recently oil among others. Harnessing natural resource wealth is a great transformative opportunity for developing economies such as Ghana. The prudent management of natural resources can provide great support to the growth and development process. By carefully managing natural resource wealth, governments can achieve sustainable growth and development of their countries. Researchers believe and history has shown that extraction of oil, gas and minerals can become an important source of export earnings, foreign direct investment, foreign reserves and government revenues. As stewards of countries' natural resources, governments have a responsibility to husband, manage and regulate natural resource proceeds in a transparent, efficient and accountable manner so that these natural assets can be transformed into sustainable prosperity for both current and future generations.

Mr. Chairman, there are two basic ways that the extractive industry creates benefits, among others:

1. Through job creation, provision of public infrastructure, export earnings, capacity building, increased government revenues, etc and
2. Through the value creation by mines, smelters, refineries, fabricating plants, and many other kinds of facilities for the society.

Mr. Chairman, achieving sustainable development, both at the micro and macro levels, is not and should not be the sole responsibility of actors in the extractive industry. We all must attempt to understand the kinds of actions and policies that are needed to move economies onto sustainable growth and development path. To be able to reap the full potential of the

extractive industries, governments must ensure strong and effective governance, not just at the national level but at all levels of governance.

Mr. Chairman, there are raging questions around building more effective structures of governance to support market competition to create abundance without undermining the values we consider important. There must also be continuous focus on harnessing the benefits of natural resources to improve the living standards of the poor and vulnerable in our society, create more opportunities for our youth, protect the environment on which we all depend, and establish more accountable and efficient institutions of governance. These goals, on a strategic level, are central to determining the future of our country. But, there are several constraints to achieving these goals. The first constraint is the capacity to achieve and sustain the objectives in the medium to long term. Secondly, we need to address the issue of adequate access to the natural resource bases; equal and easy access to capital; creation of a steady supply of high skilled labour generally. We also need to address the policy concerns of the citizens.

### **Challenges to Managing Natural Resource**

Mr. Chairman, an abundance of natural resources can be both a blessing and a curse. Most developing countries have not been successful in the management of earnings from their natural resources. Natural resources proceeds if not managed well can cause macroeconomic instability characterized by volatility in government revenues, price and exchange rate fluctuations, and their destabilizing impact on the balance of payments.

Issues relating to volatility are of a particular concern in the management of natural resource revenues because they influence both short and long run economic growth objectives. Several studies show that, resource-rich countries' revenues and expenditures suffer severely as a result of fluctuations in commodity prices, which can bring about macroeconomic instability as well as high volatility in the real exchange rate.

To minimise the complexities in financial management, growth sustainability and the creation of sustainable long term prosperity, there is the need for effective but flexible fiscal frameworks to address the problems associated with the management of natural resource revenues. There must also be institutional reforms, proper exchange rate management and careful management of the public debt. In addition to addressing these macroeconomic

challenges, it is also important to ensure inclusiveness that is by creating the conducive environment where all sectors of the economy can actively participate in the growth process. Another challenge is the “Dutch Disease Syndrome”. While this syndrome often relates to natural resource discovery, it can also refer to "any development that results in a large inflow of foreign currency, including a sharp surge in natural resource prices, foreign assistance, and foreign direct investment

There are two basic ways to reduce the threat of Dutch disease: by slowing the appreciation of the real exchange rate and by boosting the competitiveness of the adversely affected sectors of the economy. One approach is to sterilize the boom revenues, that is, not to bring all the revenues into the country all at once, but to save some of these revenues abroad in special funds and bring them in slowly. In developing countries, this can be politically difficult as there is often pressure to spend the boom revenues immediately on infrastructure projects and to alleviate poverty. But this ignores the related broader macroeconomic implications.

### **Managing Natural Resource Revenues for Economic Development**

Mr. Chairman, all over the world, the discovery and exploitation of natural resources have facilitated the process of economic growth and development, contributing largely towards GDP, exports, and domestic revenue. In most developing countries, and particularly in Sub-Saharan Africa, there is a high degree of dependence on mineral commodity exports for foreign exchange and fiscal revenues. While this dependence is declining, it is still by far the highest in the world.

In an environment of limited external financing for development, but where there is at the same time, strong pressure on governments to expand fiscal space, increasing domestic revenue from extraction of natural resources is of particular importance. Well-managed natural resource revenues provide an enormous opportunity for many of the poorest countries in the world to finance the investment needed to advance human development and accelerate progress towards sustainable development revenues.

Mr Chairman, managing natural resource revenues is also challenging. Many countries with large endowments of valuable natural resources do no better, and indeed sometimes, do worse than less endowed countries. A review of determinants of economic developments in Africa (Beny and Cook, (2009)), concluded that the share of exports of petroleum and related

products is negatively correlated with economic growth. This finding is a wakeup call to all of us to manage natural resources so as to advance socioeconomic development of our countries. But capturing and managing effectively the macroeconomic impacts of large and volatile inflows of foreign exchange from the sale of extracted resources is key to creating equity and alleviating poverty in societies. There are several suggestions on how to manage the revenues from natural resources. These include a careful design of exploration and extraction contracts that maximize the benefits for the government, efficient use of proceeds from natural resource exports, managing volatility through the establishment of stabilization funds, and increasing transparency and accountability in the management of the funds.

Mr. Chairman, the effectiveness of policies to manage risks associated with natural resources exploitation and management requires strong institutional frameworks. In fact, a large share of literature on the natural resource curse points to institutional weakness, which includes corruption, non-adherence to the rule of law, weak governance, and political interference and instability as the major causes of mismanagement of internal resources in developing countries. The development of strong independent, accountable, and transparent governance institutions that can help manage the proceeds from natural resources is important. In fact, establishing strong institutions prior to the exploration of the resource is considered one of the safest ways to avoid the resource curse. A great African example is Botswana where it has been proven that relative healthy governance institutions allowed the country to properly manage the proceeds from the mining of diamonds (Acemoglu, Johnson & Robinson (2006). Enhancing the technical knowledge of public officials and improving local content laws can help improve the ability of countries with limited negotiating capacity. Some argue that stronger transparency in the negotiation process could also reduce corruption.

Mr. Chairman, policies to smoothen out swings associated with natural resource revenues are probably the most widely used around the world. A common tool has been the use of stabilization funds. Some countries also make use of sovereign wealth funds to invest the proceeds of natural resource extraction for future use.

But, merely managing the revenue from natural resources for short-term purposes such as budgetary support is not enough. Investing the proceeds from natural resources into accumulation capital, both human and non-human capital as opposed to financing current consumption, should be an essential basis for building up capital for a long term sustainable growth. The argument here is simple: a country is on a sustainable path if its wealth is non-decreasing over time. This implies that a country that makes use of its natural resources

endowment will be sustainable if it invests the proceeds obtained from the sale of the resources into other types of capital: human, physical and institutional. Wealth management therefore suggests that assets should not be used to finance non-productive projects.

## **Key messages**

Mr. Chairman, the key messages I want to leave with you are as follows:

1. Managing natural wealth and turning it into prosperity is challenging. Countries endowed with natural riches can either find the path to increased human development or fall prey to the natural resource curse. Fiscal discipline is an important prerequisite. Proper investment and production policies as well as appropriate regulatory framework must be designed to benefit the state and the investor. The regulatory framework must ensure equity in payment of taxes and royalties. It must be a win-win situation.
2. Efficiency, transparency and accountability are crucial for the management of revenue from extraction of natural resource.
3. Local capacity should be built for state institutions and officials. Severe sanctions must be administered to extracting companies who flout the laws, and incentives given to those who do the right thing. Corporate social responsibilities of extracting companies should not be limited to only the local communities, but should be extended to neighbouring communities where there are no extraction activities as well as for human resource development.
4. Severe punitive measure must be applied to perpetrators while at the same time giving incentives to law-abiding entities.

## **Conclusion**

In conclusion Mr. Chairman, I wish to say that being well-endowed with natural resource can be beneficial to countries where the proceeds from these natural resources are used efficiently and judiciously to enhance the human development agenda. A well-managed natural resource presents a great opportunity to increase the investments required to advance human development. Evidence is available to show that discovery and exploitation of natural

resources create employment opportunities. Other benefits that come with natural resources exploitation are foreign direct investment, exports, and government revenues. Managing natural resource is however, a challenging task. Most developing countries have not been successful in this regard. Many of such countries which have discovered natural resources face difficulties when it comes to managing volatilities in government revenue, exchange rate and export prices, and their overall effect on the external balance. The success of managing natural resource hinges on a well-designed exploration and extraction arrangements that minimize the cost of production and maximize government revenues. Most natural resources are non-renewable; therefore the efficient and effective use of the proceeds of these natural resources requires strong institutions, long-term investment into human and non-human capital, among others.

Before concluding I would like to revert to the issue of the 2016 National Budget. As will be shown in the first part of the panel discussions, the 2016 National Budget faces major challenges and risks. These I hope will be fully and objectively addressed in the discussions. I hope the issue of the growing deficit, and its financing and the all-important issue of fiscal discipline will also be fully addressed with candour and objectivity. These issues are basic to our economic prosperity on a sustainable basis. The efficient, transparent and accountable management of revenues from our natural resource endowment is an important element but sound fiscal policy must be of prime concern.

Let me end by leaving you with a thought! During the period of our struggle for independence, our first President, Kwame Nkrumah, used to say “Seek ye first the political kingdom...” In our present circumstances I would say to all of us” Seek ye first fiscal discipline”

I wish the two panels fruitful deliberations and I hope that the recommendations which will come out of their discussions will make a useful contribution to the ideas that will guide, not only formulation of 2016 National Budget but also future policies.

Thank you for your attention!