INSTITUTE FOR FISCAL STUDIES

POLICY BRIEF

No. 7
January 2019

ASSESSING MANAGEMENT OF THE GHANA PETROLEUM FUNDS

1.0 SUMMARY

Ghana's Petroleum Revenue Management Act (PRMA) requires a portion of petroleum revenues to be set aside in the Ghana Petroleum Funds (GPFs) for saving and investment. This policy brief presents the findings of a study which assessed transparency and efficiency in the management of the GPFs, which were allocated approximately 28% of total petroleum revenues from 2011 to 2017. In general, the GPFs' management has accorded with international best practice in transparency, with minimal issues observed. However, the Funds' investment returns have been relatively low, reflecting the rigid investment rules set out in the PRMA. The Investment Advisory Committee (IAC), which should play a critical role in the management of the GPFs, has been dysfunctional, with serious implications for efficient management of the Funds. Amending aspects of the PRMA and reconstituting the IAC to carry out its mandate with more flexibility will help improve the performance of the GPFs.

2.0 CONTEXT AND POLICY ISSUE

Ghana started producing oil in commercial quantities in November 2010. Shortly thereafter, in 2011, a legislative framework—the Petroleum Revenue Management Act (PRMA), 2011 (Act 815)—was developed to govern the management of petroleum revenue. There has been strong public interest in the management of petroleum revenues accruing to the government, reflecting the high expectations among Ghanaians of the benefits from the sector. At the same time, problems with transparency and efficiency in petroleum revenue management have surfaced from time to time. Studies into these problems have largely focused on petroleum revenue allocated to programs in the public budget—referred to as the Annual Budget Funding Amount (ABFA)—while the rest of the revenue, which includes monies (approximately 28% of the total revenue in 2011-2017) allocated to the Ghana Petroleum Funds (GPFs) for saving and investment, has received less scrutiny.

This policy brief presents the key findings and recommendations of a study which sought to fill this gap by assessing transparency and efficiency in the management of the GPFs.[1]

3.0 KEY FINDINGS ON TRANSPARENCY

The Petroleum Revenue Management Act (PRMA) has laid down a transparent system for managing the GPFs—that is, the Ghana Stabilization Fund (GSF) and Ghana Heritage Fund (GHF)—which is broadly in accord with international best practice.

The key features of the system which ensure transparency are as follows:

- Allocation of Revenue: Authority is vested in Parliament to determine allocations to the GPFs, subject to clear rules established in the Act to help mitigate political influence in decision-making.
- Utilization of Revenue: The GPFs have clear objectives. The GSF is intended for alleviating shortfalls in petroleum revenue allocated to the budget, subject to a ceiling of 75% of the balance standing to its credit at the beginning of the financial year. The GHF, on the other hand, is an endowment for future generations. In principle, it cannot be spent, but Parliament may authorize spending of its interest income at 15-year intervals, starting from 2026.
- Reporting: The PRMA assigns reporting responsibilities to the Minister of Finance (MoF) and Bank of Ghana (BoG). The BoG is enjoined to report quarterly on the GPFs to the MoF, and semi-annually to Parliament and the public. The MoF is required to submit an annual report on the GPFs as part of the annual budget presented to Parliament. Importantly, deadlines for reporting and public disclosure of information have been stipulated, with stated penalties for non-compliance.
- Auditing: Internal and external auditing of the GPFs by BoG and the Auditor-General, respectively, is mandated, with reporting to the MoF and Parliament within stipulated deadlines.

It was found that the mandated institutions have broadly complied with their respective obligations set out in the PRMA. This has made information on the GPFs publicly available with adequate frequency, coverage and quality, and ensured transparency and accountability in the management of the funds.

Despite the general transparency, there is lack of clarity in the PRMA regarding the Minister of Finance's authority to set a ceiling on the GSF.

The Act provides that the accumulated resources of the GSF shall not exceed an amount or ceiling recommended by the MoF and approved by Parliament, and the amount shall be reviewed from time to time. Once the amount is attained, subsequent transfers into the GSF shall be allocated as transfers into the Contingency Fund (for contingency public spending) or Sinking Fund (for public debt repayment).

The question is whether the ceiling can be set below an existing balance to allow the Minister to cream off the excess into the Contingency Fund or Sinking Fund, or whether the ceiling can only be set at or above an existing balance. In 2014, the then Minister of Finance capped the GSF below the existing balance. This action attracted the censure of the Public Interest and Accountability Committee (PIAC), which argued that the ceiling could only be set at or above the existing balance.

Beside the lack of clarity, a more significant issue with the authority granted the MoF to seta ceiling on the GSF is the absence of a guideline or regulations on what should form the basis of the amount set as the ceiling.

[1] *The study, which was sponsored by the UK Department for International Development (DFID) through the Ghana Oil and Gas for Inclusive Growth (GOGIG) program, assessed management of all non-ABFA petroleum revenue, viz. revenues allocated to the GPFs and Ghana National Petroleum Corporation (GNPC), the national oil company. The methodology entailed a desktop review of key sector reports, policies and legislation, as well as meetings and workshops with stakeholder organizations in petroleum revenue management in Ghana, namely: Ministry of Finance, Ghana National Petroleum Corporation (GNPC), Bank of Ghana, Petroleum Commission, Public Interest and Accountability Committee (PIAC), Ghana Revenue Authority, Mines and Energy Committee of Parliament, Finance Committee of Parliament, and relevant civil society organizations. A separate policy brief deals with the findings and recommendations on GNPC revenue.*

4.0 KEY FINDINGS ON EFFICIENCY

A crucial element of the management structure set out in the PRMA to oversee the investment of the GPFs is not functional.

This is the Investment Advisory Committee (IAC), which the law mandates to formulate the investment policy, determine the benchmark portfolio, risk and returns, and offer broad investment advice on the GPFs to the Minister of Finance. The IAC has not existed since October 2016, thereby denying investment decisions the necessary technical input of this critical body.

The IAC's absence has a number of adverse consequences, with serious implications for efficient management of the GPFs. The first and most obvious is that its functions are not being performed. For example, neither the GPFs' investment policy nor the benchmark portfolio—a model asset portfolio required to be formulated and used as the benchmark for assessing the GPFs' performance—have been developed. Second, the PRMA's objective of incorporating expert advice from outside government in investment decision-making is not being fulfilled. Third, the IAC's absence represents a serious legal breach. Moreover, even though the PRMA seems to empower the IAC as an independent expert body to advise on the investment of the GPFs, the law at the same time undercuts the IAC's role—and its room for maneuver—by specifying a narrow range of "qualifying instruments" which the GPFs can be invested in.

Returns on the GPFs have been low based on rule-of-thumb and international benchmark comparisons.

A total amount of US$776.55 million was transferred into the GSF from 2011-2017, while US$430.63 million was withdrawn, leaving US$345.92 million as the net amount transferred into the GSF for investment. For the GHF, it received a total amount of US$323.72 million for investment in the period.

In nominal terms, average annual net interest returns of barely 1% were realized on the GPFs in 2011-17. Figure 1 shows that the annual net interest return on the GSF ranged between 0.01% and 0.75% during 2011-2017, with an average of 0.39%, whereas the net interest return on the GHF ranged between 0.01% and 1.98%, with an average of 1.18%. Comparing these returns with Ghana's cost of dollar borrowings from the Eurobond market, which ranged between 7.88% and 10.75%, with an average of 9% in the period, shows a high opportunity cost of the low level of returns being realized on the GPFs. In real terms, the net interest returns on both the GSF and GHF were invariably negative (see Figure 2), with average annual real interest returns of -1.27% and -0.49% on the two funds respectively.

Figure 1: Net Interest Reture on the GPFs vs Ghana's Dollar Borrowing Cost

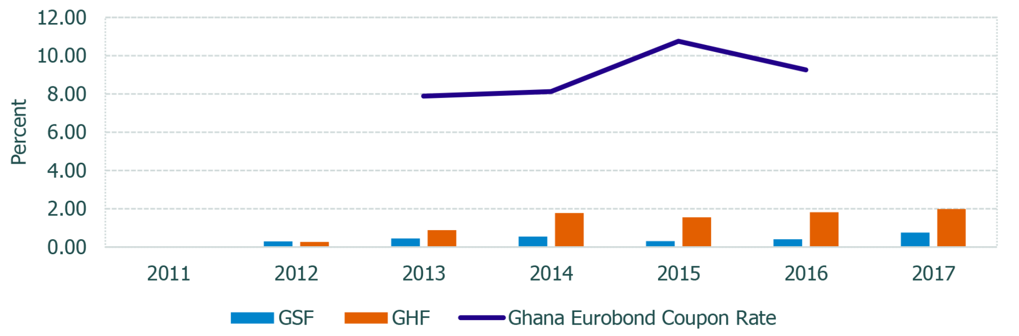
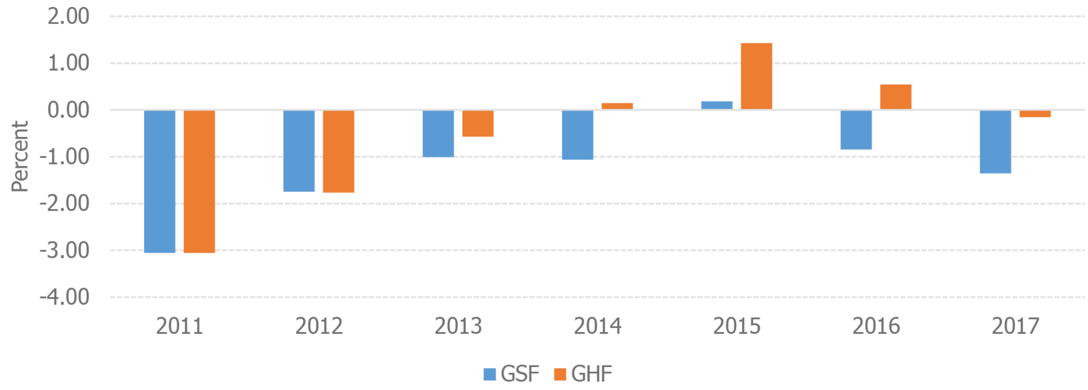
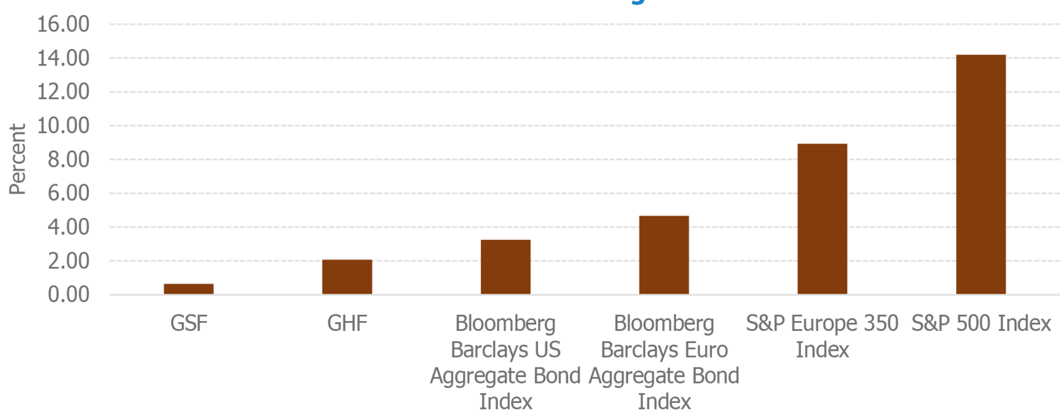


Figure 2: Real Interest Returns on GPFs



Beside the low net interest returns described above, the annual total returns on the GPFs—which calculate both interest income and capital gains (albeit unrealized) on the investments— were also found to be low in comparison with the returns on key benchmark indices for financial investments in the US and European markets, where the GPFs are invested. This is illustrated in Figure 3, which shows that the Bloomberg Barclays US Aggregate Bond Index and the Bloomberg Barclays Euro Aggregate Bond Index—which are common benchmark indices for evaluating the performance of fixed income portfolios in the US and European financial markets respectively—recorded average total returns of 3.25% and 4.67% in 2011-17, against the average total returns of 0.64% and 2.07% on the GSF and GHF respectively. Figure 3 further shows that benchmark equity indices in the US and Europe like the S&P 500 and S&P Europe 350 returned 14.19% and 8.92% over the same period that the GPFs were invested with much lower returns.

Figure 3: Mean Total Returns on the GPFs vs Returns on Key Benchmark Indices During 2011-2017



The comparatively low returns on the GPFs are largely due to the PRMA's narrow range of permitted investments, which derive from the qualifying instruments specified in the Act. The qualifying instruments confine the GPFs to be invested in fixed-income, high-liquidity, and investment-grade instruments issued or guaranteed by an investment-grade sovereign or one of the major multilateral institutions. Although this prescription ensures relative safety and low risk of the investments, it also leads to low returns. Permitting diversification of the funds' investments across different asset classes and markets is likely to improve yields.

5.0 POLICY RECOMMENDATIONS

The PRMA should be amended or regulations developed to establish, clearly, how and what should form the basis for setting the ceiling on the GSF.

One option would be to fix a floor for the balance that sits in the GSF at any point in time. Since the GSF is intended to alleviate shortfalls in petroleum revenues allocated to the budget, the floor could be set as a percentage of the Annual Budget Funding Amount (ABFA).

The IAC has an important role to play in the governance structure of the GPFs and should therefore be reconstituted.

The IAC should be given the necessary resources to fulfill its mandate, which includes formulating the investment policy, determining the benchmark portfolio, risk and returns, and monitoring the performance of the GPFs.

The PRMA should be amended to eliminate or relax its rigid investment rules, such as the narrow range of qualifying instruments, for the GPFs.

This way, the IAC, as well as the MoF and BoG, will gain flexibility in decision-making on investing the GPFs. The GPFs portfolio should consequently be diversified to include equities and other long-term, high-yielding assets. This will enable the returns to be increased. Since it will also increase risk, the benchmark portfolio that the IAC develops must ensure that the overall portfolio risk is appropriate and well-balanced.

INSTITUTE FOR FISCAL STUDIES

Residential Address
No. 13, 2nd Close, Airport Residential Area, Accra, Ghana

Postal Address
P.O. Box CT 11260, Cantonments, Accra, Ghana

+233 302 786 991
info@ifsghana.org
www.ifsghana.org

Supported by the Ghana Oil and Gas for Inclusive Growth