A Financial Loss That Could Have Been Avoided

Statement Issued By the Institute for Fiscal Studies (IFS) and IMANI

7th April, 2015

On Thursday, 12 March 2015, the Minister for Finance appeared before Parliament to make a statement on the implications of the falling crude oil prices on the 2015 Budget. The Minister also used the opportunity to inform the House of the steps government has taken to address the issue to ensure that its macroeconomic objectives are achieved.

According to the Minister, the sharp decline in crude oil prices on the world market has posed challenges to the achievement of the 2015 economic program. The crude oil price fell sharply from US$115 per barrel in July 2014 to US$47 per barrel in January 2015 and many analysts believe that oil prices could hover around an average of US$50 per barrel in 2015. Meanwhile the petroleum benchmark revenue price estimated and used in the revenue projections in the 2015 Budget was US$99.38 per barrel and a volume of 102,033 barrels per day was also estimated for the year. Consequently, the total petroleum receipts for 2015 is estimated to drop by a whopping GH₵2.7 billion or 64.4 percent, from GH₵4.2 billion to GH¢1.5 billion. In addition, a substantial decline in corporate income tax revenue from oil companies, arising from the huge drop in total petroleum receipts, is also imminent. This is because the production costs for some of the oil companies will outstrip their revenues and result in losses. Apart from the direct impact on petroleum receipts, the decline in crude oil prices is also likely to impact negatively on the special petroleum tax announced in the 2015 Budget. For this, an amount of GH¢185.6 million is estimated to be lost.

The Minister pointed out that, the fall in crude oil prices as well as the current energy crisis and the rapid depreciation of the cedi in 2014 and recently in 2015 would have a strong negative impact on overall output. As a result, the government estimated that taxes on domestic goods and services as well as non-oil taxes on income and property could be lower than the original estimates in the 2015 Budget by GH¢358.7 million. In total, domestic revenue for 2015 is expected to drop by GH₵3.1 billion to GH¢27.8 billion, reflecting a shortfall of 10 percent. The drop in domestic revenue resulting from the decline in crude oil prices could be slightly reduced by the expected increase in grant disbursements following the approval of a three-year arrangement under the Extended Credit Facility by the IMF and pledges from development partners to disburse additional GH¢381.1 million to support the 2015 program.

In summary, total revenue and grants for the 2015 fiscal year has now been revised to GH¢29.7 billion (equivalent to 22.3 percent of GDP) instead of GH¢32.4 billion (equivalent to 24.0 percent of GDP), resulting in a shortfall of GH¢2.7 billion (equivalent to 1.7 percent of GDP).

The question that arises is why couldn’t the country avoid the loss of the GH₵2.7 billion? Why did the government stop using the hedging program that was successfully implemented between 2010 and 2012 to mitigate the losses?

In the past, the government hedged crude oil prices as part of measures to reduce the impact of oil shock on the economy. In fact in March 2010, Cabinet approved the government's request to establish a National Risk Management Committee submitted to it by the Minister of Finance whose primary responsibility was to implement a hedging program to contain the risks of crude oil price volatility. This Committee, which was composed of representatives from the Ministries of Energy and Finance, Attorney-General's Department, Bank of Ghana, Ghana National Petroleum Corporation, Cocoa Marketing Company, and Volta River Authority reported to Cabinet through the Minister of Finance.

Ghana's hedging program was tremendously successful and, together with other prudent policy measures pursued by the government, it brought about one of the longest periods of monetary and fiscal stability in the history of the country's economic management. In the first two months of the hedging program, marginal losses were made, but thereafter the program recorded significant net surpluses, which rose to US$98.4 million (net of premium costs of $63.7 million) in August 2011.

The success of Ghana's program played an important role in publicizing oil hedging to the African continent. For example, Marc Mourre, Vice-Chairman, Commodities, and Managing Director of Morgan Stanley had this to say: "Following Ghana's example, a few other countries in north, west and central Africa have been looking at the same thing". It was rumored that Senegal was close to announcing a similar program in 2011, and with the advantage of hindsight, establishing a cap on fuel import costs was going to be beneficial to the country. Ghana's successful program also sparked interest in hedging among major producers. Nigeria was entertaining the idea and called a few banks to help the country to establish what would be their option. Sovereigns who had made public their hedging plans before Ghana joined the club include the USA, Mexico, Panama, Ecuador, Russia, China, Chile, Qatar, Sri Lanka, Indonesia, and India.

Considering the tremendous success of the hedging program between 2010 and 2012, it is difficult to understand why the government discontinued the program in 2013 and has refrained from resuming it despite the current situation? Why did the government allow the impact of the falling oil prices to force the Minister of Finance to dig deep into the Stabilization Fund and also adjust downwards expenditures, including the already low and much needed capital expenditure? From all indications, the external account will also be battered by the precipitous decline in oil prices as the country relies on oil export earnings for a sizable proportion of export revenues. The falling oil price will thus not only undermine the government's efforts to reduce the fiscal deficit but it will also increase the current account deficit. The cedi which was also tumbling even before the oil prices started dropping in July 2014 is now under extreme pressure. Foreign direct investment inflows to the oil sector could also decline amid falling margins. The revised fiscal deficit target for this year has also gone up by 1.0 percentage point of GDP and the long-term outlook is murkier if oil prices do not recover. Where does this leave the much touted fiscal consolidation efforts of the government?

What is baffling many Ghanaians is why the government has been so reluctant to resume the hedging program which was deemed to be very successful in the past. This is so because the country has a team of people with the technical capacity and understanding of how the hedging process works. Not only that but also the country has counterparty banks available and willing to underwrite the hedging arrangement. And more importantly, the hedging program has been tested in the country and has proved successful and beneficial. So what is the rationale for the government's hesitance to activate the program?

And why did Parliament not ask the Finance Minister when he appeared before it on Thursday, 12 March 2015 the reason why the government did not hedge against the falling crude oil prices, leading the country to lose a whopping GH₵2.7 billion and causing important expenditures to be cut?

The Minister of Finance is very much aware of the benefits of commodity price and interest rates risk management. In fact to mitigate the risks of rising interest rates during the early part of 2013, the Minister submitted to Cabinet an interest rate risk management proposal and received approval on 2 April 2013. The same proposal received Parliamentary approval on 15 July 2013. The Minister of Finance thus knows that he is expected to manage the country's economic risks, but not to add to them through inaction. The inaction of the Minister has dangerously exposed the country to avoidable risks. The drop of GH₵2.7 billion in this year's expected oil revenue is a financial loss that clearly could have been avoided. Ghanaians are demanding an explanation from the Minister of Finance for causing such serious financial loss to the state.

Comments on this statement should be sent to the Executive Director, IFS (info@ifsghana.org) or to the President and CEO, Imani (info@imanighana.com).