Regional Conference on "Fiscal Management of Mining and Petroleum [Resources] in West Africa"

KEYNOTE SPEECH

BY

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Fiscal Management of Mining and Petroleum [Resources] in West Africa"

1. Honourable Minister for Finance, Ken Ofori-Atta

Honourable Ministers and Government Officials from Ghana, Nigeria, Senegal, Sierra Leone, Niger, Mali, and Mauritania.

The Deputy Managing Director of the IMF, Carla Grasso

IMF Resident Representative, Natalia Koliadina

Invited Guests, Ladies and Gentlemen

2. It is my pleasure, on behalf of His Excellency, The President, Nana Addo Dankwa Akufo-Addo, to welcome you all to Ghana and to this most important conference.

3. Also, on behalf of our African colleagues represented here, we wish to extend our gratitude to the Africa and Fiscal Affairs Departments of the International Monetary Fund for putting this conference together.

Ladies and gentlemen.

4. With your permission, I will like to break my address to you in two parts:

a. The conventional approach to the subject of responsible fiscal management of natural resource revenue flows, and

b. Emerging issues demanding consideration in developing our models

Conventional Approaches

5. Blessed we are with vast natural resources, for many countries, these hidden resources have turned into a “resource curse”. Our development seems inversely related to our resource abundance. While natural resources are intended to generate revenues for development, in many places, they have led paradoxically to political instability, economic stagnation. For many in sub-Sahara Africa, take DRC Congo, Sierra Leone, South Sudan, for example, resources have brought trouble-violence, wars and other forms of conflict, the falling apart of public services and social deterioration.

6. While Ghana’s case does not fit neatly into these models of resource curse, – for example we have not had armed conflict over natural resources – Ghana, however, presents a case study in how political economy-driven decisions based on the expectations of revenue flows can lead to uncontrollable fiscal exuberance and monetary indiscipline.

7. Between 2000 and 2007 before the discovery of oil in commercial quantities, a disciplined fiscal consolidation regime was the key plank in our macroeconomic stabilization process. During this period Ghana's external debt deceased from 156.3% of GDP to 17.2% in 2006. From a high of 40.5%, headline inflation also declined to 12.7% by 2007 and Gross International Reserves went from less than a month's cover at US$233 Million to about three months cover of US$2.84 Billion by 2007.

8. However, the discovery of oil and its rapid development into production will change all that. The prospects of expected oil revenue inflows from 2010 raised the expectations that oil will propel Ghana out of its economic difficulties. Coming as it did at the time of the 2008 elections, it gave government a false sense of a widened fiscal space. Government pursued an expansionary fiscal policy from 2007 to 2008 causing it to lose its grip on the macroeconomic stability it had achieved over the preceding seven years. Budget deficit increased to 6.5% of GDP by end of 2008 from 4.8% in 2006. Inflation followed rising to 18.1% from 10.9% while the annual exchange rate depreciation worsened from 1.1% to 20.1% by the close of 2008.

9. Fiscal exuberance went from bad to worse when a new government took over after the election and when oil production begun in 2010. The new era was marked by a combination of a deterioration in public finances (marked by rising public debt levels, higher debt burden, declining capital expenditure), loose monetary policy, deteriorating external payments position, declining real GDP growth, and massive corruption, mostly in public procurement. By the time the government was voted out of office real GDP growth has plummeted from the oil-driven high of 14+% in 2011 to 3.6% in 2016. Fiscal deficit reached 9.3%, and interest in Ghana's debt alone was about the size of the entire public sector debt in 2008.

10. With the lessons learnt over the years, Ghana is back on the track of fiscal consolidation and discipline once again under this new government. The question is how can we create systems and structures to ensure 'irreversibilities' in building a governance framework that first, prevents a resource curse, and, second, which makes it possible to use natural resource endowments to accelerate development in a sound macroeconomic environment?

11. Part of the answer lies in the central role of government behavior; that is, how government develops its policies around resource exploitation, its strategic development agenda, its legal framework and regulations, how the industry is organized, the benefit sharing arrangements, and how it leverages its resources to catalyze its development agenda. And that brings me to the emerging paradigm and the rethinking about the pathways for our economic transformation using our natural resources across the continent led by the African Mining Vision and championed by our own African Center for Economic Transformation (ACET) led by Dr. K. Y. Amoako.

Emerging Issues

12. All over Africa, there is a strong feeling, not only by governments, but also by citizens and civil society, that the rents form resource extraction is very large. Yet the sharing of benefits between the resource owner (acting on behalf of citizens) and resource companies has historically been contentious, and that many citizens are not receiving their fair share of the value created along the entire value-chain of their rich, raw natural resources; be it from cocoa, timber, coffee, gold, diamond, bauxite, uranium, and rare minerals to oil and gas.

13. Let me point to five areas of concern:

a. The role of government in mining and oil and extraction

b. Revenue leakages by means of **improper accounting for resources**

c. Locking out of resource-rich countries from the **high-value ends of value chains**

d. Limited local content and the lack of**fullparticipation of local businesses** in resource industries, and

e. **Growing revelations of illicit financial flows** through 'external accounts' and mispricing of trade transactions

14. First, on the role of government in extractive activities, the orthodox view is that resource-rich country governments should simply focus on maximizing their benefits from extractive activities through a combination of royalty-profit tax as revenue. This view is sound on efficiency grounds. But that view relies on the relative efficiency of markets which is not always the case.

15. More worrying, that view also gives short shrift to any state involvement in mining activities as costly, likely to make mining unprofitable, and potentially a source of enormous corruption.

16. But the market view is not entirely without its problems. The idea that governments should rely on its royalties and profit taxes alone is based on strong information assumptions. Not least are that the capital costs, and operating costs (including management fees and cost of borrowing) in determining profit before taxes are indisputably verifiable.

17. That assumption is likely not to be met and that has been the case in practice. Indeed transfer pricing practices, “hard to verify” head office or management fees arguably have been major sources of concern, of erosion of tax bases, and conduits

of illicit financial flows by resource companies. Increasingly across the continent, the "watchman" role of the state has not been seen as developmental enough. The search for new pathways is reviving the debate about state equity participation, especially in mining.

18. **Second,** improper accounting for extractive resources on the part of concessionaires is a major source of revenue loss for African countries with significant negative fiscal implications. No fiscal management system of mining and oil revenues can be robust without including measures aimed at properly accounting for the resources extracted as the recent experience of Tanzania has shown.

19. In March last year, the new government of President Magufuli ordered forensic chemical examination of container-loads of copper and gold concentrates which were being shipped out of Tanzania. The examination revealed, though disputed, that the containers had more than fourteen times the quantity of gold reported by the mining firms.

20. In Ghana, the major mining firms have been assaying gold mined from their mines by themselves before export even though the law empowers the Precious Minerals Marketing Company to do so. While we must careful not to impute, and no such thing is being alleged, it is simply not acceptable that for a very long time an institution of state with the powers to help in properly accounting for our mineral resources was not enabled nor allowed to perform its job. This has to change. I know of a bauxite mining company that over the last five years has paid no dividends to government because it claims it has made no profits yet it continues to mine vigorously. This cannot be right.

21. Thankfully we have now begun conversations about the process of making sure that every single bar of gold leaving our shores is properly weighed, tested, valued, and accounted for. While the process may not be as robust as we want, it is a positive step in the right direction and we are impressed with the collaboration between the Ghana Chamber of Mines and the Precious Minerals Marketing Company in making sure we expedite the full spectrum of accounting for our gold resources.

22. I would also like you to consider during your deliberations the difference between the contracts in the oil and mining sectors. In the oil sector for example, for a 100 barrels of oil drilled, per the contract, we know what Ghana's share is. This is not the case for a 100 tons of gold mined. Why should there be such a difference?

23. **Third**, another challenge with fiscal implication is the locking out of resource-rich countries from participating in the high-value end of the value chain. An example is the unsustainable proposition that

"West Africa,[which] produces and exports 65% of cocoa beans in the world, earns only between 3.5% and 6% of the final price of a chocolate bar"!Value addition is imperative if we are to maximize the potential to pursue resource-based regional industrialization.

24. In Ghana, we are considering a progressive process which will hopefully require the refining of a significant proportion of all gold ores and cocoa beans locally in about five years. This will not only create private sector jobs and ease the pressure off the public sector but also increase the potential sources and value of resources for government spending on critical infrastructure and social services. While gold is currently the most important one, there is potential in the development of other minerals such as manganese, limestone and bauxite in order to boost our supply chain development.

25. **Fourth**, there is a re-energized push by many African countries for a paradigm shift from the minimalist view of "**local content**" to a maximalist one of "**local participation**" when it comes to our natural resources. Resource-rich countries in Africa must not be in a situation where concession-holders rather create selective space for 'local content', instead of them being 'at the table, participating in main meal. This trend is particularly strong in markets in which the natural resource sectors have long been de-risked and for which the countries need not be paying premium to attract foreign capital and participants any longer.

26. **Finally**, fiscal resource management models should make allowances for the impact of Illicit Financial Flows (IFF) and how they impact the fiscal position of resource-rich countries. Global Financial Integrity, using the World Bank and IMF models, estimates that IFF from Africa in the 39-year period between1970 to 2008 was about US$854 billion.

27. Concessionaires that usually participate in IFF usually do so through 'external accounts' and mispricing of trade transactions and management fees. Ghana is not immune to such practices. For example, in a de-risked Oil and Gas sector such as Ghana's, there is no justification why an oilfield operator in Ghana should make claims for millions of dollars in "headquarters costs" ostensibly covering its externally-based Ghana team to its local operations in Ghana. There is the need to stem the abuse of these channels which essentially saddle resource-rich countries with a large part of the costs of exploration. The revenue envelope for African countries can be greatly enhanced, which, given competent management and fiscal discipline, creates the space needed in order to borrow less to finance their budgets.

Ladies and Gentlemen

28. To sum up, I want you, as representatives from all sides of the natural resource industry, private and public sector, as well as multilateral agencies, to avert your minds to the critical issues I have raised as you deliberate the issue of fiscal management of our resources and factor them in the development of your models.

29. President Nana Akufo-Addo speaks for all Africa when he says we are in a hurry to build a **"Ghana Beyond Aid"**. In crafting "Ghana Beyond Aid" as a vision for our country's economic transformation, he has managed to capture in three simple yet powerful words a renewed approach to Africa's engagement with the world: an **'Africa Beyond Aid'**, focused on trade and investment with fair sharing of the value for its natural resources. In this new relationship, extractive resources are to be leveraged in 'Value-Added Resource-for-Infrastructure' deals, fully aware of the risks of barter arrangements. We are currently championing such arrangements in trying to develop our infrastructure on the back of an Integrated Aluminium Industry using our bauxite deposits.

30. No fiscal management of our revenue flows from natural resources, nor an Africa Beyond Aid, can be achieved without also:

a. Paying attention to the central role of government behavior in resource control and benefit sharing arrangements;

b. Plugging the revenue leakages through **improper accounting for resources**

c. Scaling up our participation in the **high-value ends of the value chains**

d. Ensuring **fullparticipation of indigenous businesses** in resource industries, not just providing ‘content’, and

e. Working together to **stem the illicit financial flows** that takes place daily in the sector.

31. I wish you all a successful, enlightening conference, and for first time visitors to Ghana, I invite you to savour the food, the entertainment, and the delights that this beautiful country offers before you return to your home countries.

32. Thank you for your time and I hereby declare this conference open.